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Editorial Comment

A Memorable Month

The month of November just passed has witnessed a number of events of world-wide importance. The outstanding one was the re-election of President Roosevelt who received so unprecedented a mark of his country's confidence as to be returned for the third time as head of the government of the American nation. No election was ever watched with more intense interest than this one, especially by the other democracies who felt they had the sympathy and support of this great man—a lover of humanity and an upholder of the principles of true democracy. For that reason the dictators were hoping for his defeat. While the British Empire in its war against banditry and murder would have had the support of Mr. Wilkie also had he been elected, Mr. Roosevelt's retention in office nevertheless will mean no delay in the present program of full power ahead until that day is reached when peace, honour and goodwill shall prevail throughout the world.

. . . .

It was Andrew Jackson who once said, "Peace, above all things, is to be desired, but blood must sometimes be spilled to obtain it on equable and lasting terms." Those words might equally have been uttered by the Hon. Neville

Chamberlain who passed away on the ninth of November. "It fell to Mr. Chamberlain, in one of the supreme crises of the world, to be contradicted by events, to be disappointed in his hopes, to be deceived and cheated by a wicked man," said Prime Minister Churchill when in the House of Commons he paid tribute to the memory of this great Englishman. "Whatever else history may or may not say about these tremendous, terrible years, we can be sure that Neville Chamberlain acted with perfect sincerity according to his lights. He strove to the utmost of his capacity and authority—which were powerful—to save the world from the awful devastating struggle in which we are now engaged . . . When, contrary to all his hopes and all his beliefs and exertions, war came upon him—and as he himself said, all he had workea for was shattered—there was no man more resolved to pursue the unsought quarrel to the death." His remains lie in Westminster Abbey with those of other truly great men of our Empire. Like the righteous man he acted justly, showed mercy and walked humbly with his God.

. . . .

Clime of the unforgotten brave!
Whose land, from plain to mountain cave,
Was Freedom's home, or Glory's grave;
Shrine of the mighty! can it be,
That this is all remains of thee?

If Byron were living today he would have a more eloquent tribute to pay to Greece than he expressed in these words a little over a century ago. The rallying of the Greeks to the defence of their country against an unprovoked invasion by Italy will have a place in the annals of the outstanding events of the year 1940. This nation "where [once] grew the arts of love and peace" has just demonstrated that not all its ancient glory is dead. From these heroic achievements against the Italians and from the glorious deeds of the British in the Mediterranean, the temporarily overrun democracies of Europe are taking new courage and are beginning to see more clearly the dawn of the day when the cold-blooded tyranny of the Axis powers will be overthrown and the nations dwell together once more in unity.

Trade Expansion of Canada

During the first year of this war which Germany forced upon the peace-loving peoples of the world, Canada has displaced that country as the third highest exporting nation and now stands next to the United States and the United Kingdom. This remarkable accomplishment of a country of eleven million population was revealed in a statement given to the Canadian press a few days ago by Hon. James A. MacKinnon, Federal Minister of Trade and Commerce. The important inference to be drawn therefrom by Canadians was voiced by the Minister when he said, "In the first year of the war crisis, the English-speaking nations, that is the British Empire and the United States, have dominated and still dominate world trade. This is convincing evidence of what the end of the conflict must be. Resources are the sinews of war as never before. To be able to transport these resources and deliver them where they are required is the keynote of victory."

According to Mr. MacKinnon the total trade of Canada during the first twelve months of war has been larger than that of any year during the previous ten years and exceeded the two billion dollar mark—$2,149,000,000, which is an increase of $592,000,000 over that of the previous twelve months. The exports of Canada's products at $1,150,000,000 exceeded by $159,000,000 the imports for the corresponding period and is an important factor in the building up of Canadian credits abroad. Of further interest is the fact that these figures do not include our shipments of gold.

In explanation of this expansion of export trade, Mr. MacKinnon states: "The cutting off of our trade with the countries overrun by the Nazis left more open to us many of the markets which Germany and her conquered peoples had been supplying. For example, exports to British Empire countries, other than the United Kingdom, have increased by $28,000,000, bringing that export up to $130,000,000. The United Kingdom was the outstanding and first market to be filled. Goods which had been obtained from the Axis powers and the countries now dominated by them had to be purchased elsewhere. Canada has supplied much of what was required and our exports to Great Britain alone rose from $341,000,000 to nearly $465,000,000, an increase of 36 per cent. That increase will, in all likeli-

hood, be exceeded in the next few months. Our exports to the United States have risen from $314,000,000 to nearly $463,000,000 or around 47 per cent."

Type of Exports

The production and shipment abroad of war materials is one reason for this rise in volume of the exports of our country, but it is not the chief one because, as Mr. MacKinnon points out, vast increases in exports have been made in newsprint, wood pulp, automobiles, lumber, meats, wheat, wheat flour, fish and a great many other commodities.

It is noted that in the exports to neutral European powers, those to Portugal have increased from $124,000 to $939,000, to Spain from $23,000 to $518,000 and to Switzerland from $666,000 to $2,115,000. The exports to Portugal are mainly wheat, rubber tires, wood pulp, newsprint, paper and asbestos; to Spain, automobiles, scrap copper and asbestos; and to Switzerland, wheat, rubber, upper leather, copper rods and asbestos. Is there a possibility that some of these exports are reaching Germany and Italy or countries under their control? Mr. MacKinnon has an assurance for the people of Canada against such possibility. "I should like to allay any fear," he says, "which may exist that our exports to such neutral countries as Portugal, Spain and Switzerland are finding their way into the Axis-governed countries. That has been taken care of. But these neutrals have had to import from Canada certain goods previously brought in from other countries."

Education for Post War Period

The reference made recently by the Honourable Mr. McLarty, Federal Minister of Labour, to the importance of education and of technical training during the present period in preparation for employment after the war should be drawn to the attention of all parents and of every school district in our land. According to the reports of many school boards throughout the Dominion the attendance of boys and girls from 14 to 16 years of age has fallen off recently owing to the increase in employment opportunities. It is a situation brought about by our war activity, and the unfortunate aspect of it is that these young people do not realize the seriousness of dropping studies at this stage, the importance of their having greater educational qualifications, and the difficul-

ties in store for them when seeking employment after the war. The earning of a few dollars has for them greater attractions than building a sound foundation for their future careers. Parents, teachers, and the public press, then, should make it their business to emphasize the wisdom of continuing studies until the pupil completes at least the high school or the technical training course. The boy or girl who does not follow this advice faces a grave risk of becoming unemployed later because of the lack of a fundamental background of knowledge. "We are instituting a system of unemployment insurance," Mr. McLarty said, "but fundamentally the best insurance against unemployment insurance is a trained mind and hands."

While we are on the subject of education, a word of advice to those over sixteen years of age is not amiss. The opportunities for education which are open to all in Canada are unlimited; no country in the world has greater facilities for those who find themselves forced to leave school before proceeding to the more advanced courses. In the cities throughout our Dominion, night classes exist in practically all subjects of the high school curriculum and, in many of them, complete courses in technical education. In fact some departments of education have become so concerned about bringing educational opportunities to those in remote and sparsely settled districts that they are providing school trains and correspondence or extramural instruction in many subjects. From our own experience in the educational field we have found that when a student is thrust to a considerable extent upon his own responsibility, his resourcefulness comes into play, his mind becomes alert, and his efforts for self-improvement under difficulties, backed by perseverance and application, have their reward. Moreover, his studious habits continue long after the winning of a "certificate," and managers of most business and industrial firms will acknowledge that those who have made the greatest advancement with their firms are the ones who continue to give over part of their spare time to systematic study.

The action of the committee on education of the Canadian Legion War Services Inc. in providing for free correspondence courses for men on Active Service is deserving of the highest praise. Courses have been put up in text-

booklet form and include courses preparatory to the high school curriculum, secondary courses for high school credit, and technical-vocational courses. Any man on active service may enroll for a course and, wherever he may be, arrangements are made for the correction of his work. In this laudable enterprise, the Legion has the co-operation of the Departments of Education in Canada and Newfoundland, the Canadian Association for Adult Education, the Canadian Teachers' Federation and other educational bodies.

Rise of Employment

Some idea of the increase in employment in Canada arising from the pronounced expansion in industrial activity can be obtained from a carefully prepared table published in the *Monthly Review* (October) of The Bank of Nova Scotia. This shows the percentage increases in employment during the first year of the war for thirty leading industries. The first group of fourteen industries are those which have been supplying vital war needs and the increases range from 21% in electrical apparatus to 324% in shipbuilding. Belonging to this group are the metal-working and machinery industries, chemical and certain branches of the textile trades.

The impetus given to the building trades is also referred to in the Bank's review. Construction contracts for industrial purposes during the first nine months of 1940, it points out, were more than four times as great as in the same period of 1939. In addition, military requirements have called for the construction of air fields, training schools, barracks and supply depots. The result of all this is that during the first year of war Canadians have witnessed the largest increase in industrial employment and production which has ever been recorded in Canadian statistics within a period of twelve months. Can this increase go on indefinitely? "The first 20% increase in industrial activity has proven relatively easy," states *The Review*. "The second 20% increase will be more difficult. The reason is not far to seek, for we have utilized a great deal of the idle plant capacity and much of the reserve of idle and only partly-occupied labour which so facilitated the expansion of the past year. In many industrial centres, most of the unemployed who were readily employable have been

absorbed into industry and into the armed forces. While this does not mean that we shall soon reach the peak of our production, it does suggest that the rate of expansion in our total production may well become less rapid during the course of this second year of the war."

Rowell-Sirois Report

In our issue of June last there was published a summary of the principal recommendations contained in the report of the Royal Commission on Dominion-Provincial Relations which had just then been tabled in the House of Commons. For months following the presentation of the report there appeared to be a serious danger that this document, like the reports of many other Royal Commissions, would be filed away in musty archives—as tangible evidence, if nothing else, of certain items of expenditures in the public accounts having been duly made. Within the past month, however, new interest in this report has been awakened through the action of the Prime Minister in calling a conference of representatives of all the Provinces and of the Dominion next January. The general reaction to Mr. King's move is more than ordinarily favourable. "So far as the Sirois report is concerned," states the *Calgary Herald*, "public opinion has arrived at the conclusion that this is a present and not a post war matter. Its proposals are of a nature to call for early application. Any tendency to postpone consideration until after the war, which may be several years hence, would be deplorable and possibly dangerous." In its comments on the January conference and on the fact that no previous assemblage has been so well equipped to deal with questions of Dominion-Provincial relationship, the *Winnipeg Free Press* makes the observation that "the Report of the Commission and the attendant studies have made it clear to all that our existing Federal system is no longer adequate to the requirements of Canada; and that to persist in retaining it intact will be to invite disaster and perhaps to make disaster inevitable."

Public sentiment in favour of the majority of the recommendations of the Commission being implemented at this year's session of Parliament is growing. In order that our readers, who do not possess a copy of the three-volume report, may learn its main features, the editorial committee fortunately has been able to secure a series of three

articles by Professor J. A. Corry of the Department of Political and Economic Science of Queen's University. In his first instalment Mr. Corry proposes to deal with Book I, explaining how we got into our present difficulties; in his second, to outline the Commission's plan for getting us out of these troubles; and in the third, to deal in some detail with the particular recommendations of the Commission. The first of the articles appears this month; the second and third will be published in the January and February issues.

Kenneth Dalglish Honoured

Members of the profession from Nova Scotia to British Columbia received with satisfaction the announcement early in November of the appointment of Kenneth W. Dalglish as one of the three members of the Board of Referees set up under the provisions of *The Excess Profits Tax Act, 1940.* Mr. Dalglish is a distinguished member of the profession, and during 1939-40 was President of The Dominion Association of Chartered Accountants—the highest office in the gift of the profession in Canada. Prior to that he had served on a number of active committees of the Association, including the Legislation Committee of which he was chairman, and in 1936-37 was President of the Society of Chartered Accountants of the Province of Quebec. The whole membership will agree that the choice of the Government was a wise one and the honour well deserved.

Associated with Mr. Dalglish on the Board are Mr. Justice Harrison of the New Brunswick Supreme Court, and Charles P. Fell of Toronto. The chief function of the Board will be the determination of standard profits for new businesses and for those in depressed industries.

THE VALUATION OF UNLISTED STOCKS FOR SUCCESSION DUTY PURPOSES

By H. D. Clapperton, Chartered Accountant, Montreal

IN valuing stocks for succession duty purposes no difficulty as a rule arises if these are listed. The market value is indicated by the stock exchange list if the stock is active. If the stock is inactive it is still, as a rule, possible to determine approximately the market value. If the stock is not listed and is not traded in, it is not easy to ascertain the value on which succession duty should be paid, particularly so is this the case when restrictions are placed on the transfer of the stock in question. Some governments confronted with the problem try to resolve it by methods which are more or less arbitrary.

In one jurisdiction it is provided that "The value of any security which is not listed or on which no price or quotation is obtainable is the value determined by the provincial treasurer and such value shall be deemed to be the value of such security and shall not be subject to review by any court notwithstanding anything contained in the Act." The Act does not lay down in what manner the provincial treasurer is to determine the value of the stock. Presumably, he will seek to determine the value according to the methods generally observed by stock analysts. He may, however, follow the method in use in the Province of Quebec which gives weight to balance sheet values as well as to earnings.

Some jurisdictions are willing to concede that the value of securities not publicly listed and not freely traded in is a matter on which opinion may reasonably differ. The Province of Quebec Succession Duty Act states that if the securities are not freely traded in resort is to be had to balance sheets and other sources of information to determine what is called their *real value*. The words italicized are those of the writer. What *real value* is may be open to question—there are so many kinds of value that may be the real value; it depends on one's point of view and scale of values. For purposes of this article it is assumed that the value meant is what the stock analyst terms the intrinsic value. What is the intrinsic value of a stock? It is the value which is said to reside in the stock itself, apart from any value

that the stock has to a particular owner, or in the case of a listed stock, the price for which the stock might be sold.

Securities are acquired because it is assumed that their possession will confer some benefit on the owner. Some of the benefits are dividends, increase in capital value, freedom from taxation or control. The value of some of these benefits may be lessened somewhat because of taxation, restrictions placed on disposal of stock or other reasons. It is impossible to enumerate every factor that may have bearing on the value of a stock. It may be said, however, that as a rule the value of a stock is largely determined by its estimated future earning power. This is usually indicated by the earnings of the past.

It is sometimes contended that earning power is not the factor that determines value in the case of a company whose assets or the bulk of whose assets consist of readily realizable securities.

The stock of investment trusts is usually valued on the basis of liquidation value of the assets and the earnings ignored. This may be very well in the case of a company of the fixed investment type where the investor has power to withdraw. It is not apparent that this method of valuation, where the investor has no power of withdrawal, is the correct procedure. Where the investment trust is not of the fixed type and the shareholder is a minority shareholder, there seems no reason why a different method of valuation should be applied to that of other companies.

Assets like cash or those which can be immediately turned into cash are usually referred to as "Cash assets." When part of the assets of a company consist of cash assets it may be essential for valuation purposes to determine how far these are necessary to the existence of the business and, if deemed unnecessary, to exclude these from the assets. The earnings from these assets should also be excluded from earnings of the company. This exclusion from assets and earnings results from the idea that these assets could be declared as a dividend.

In valuing a stock on the basis of earning power, the earnings spoken of are, naturally, the normal earnings. Capital and non-recurring profits should be excluded. This is familiar ground to the accountant. The same consider-

ations prevail and govern the ascertainment of earnings as would if the accountant were stating these for a prospectus.

The rate at which these earnings should be discounted is usually a fruitful topic for discussion. The business man who understands and is subject to the hazards of industry, will usually contend that 10% as a rule is practically the minimum rate for such an investment. The hazards of industry he has in mind are probably,—

(1) Those which affect the particular company in production and sale of the commodity;

(2) Those which affect the industry of which the particular company is a part;

(3) Those arising from general economic and social conditions.

It is not necessary, however, to enlarge on the hazards of business; every investor has experienced them.

New inventions and the change in social habits have affected nearly all industries. Examples are to be seen on every hand and the process continues with unabated pace. It is interesting to turn to the stock exchange list of, say, fifteen years ago and see how many companies then regarded as first rate investments have fared. Many have been wound up and others still in existence are not nearly so highly regarded. The rate of mortality in business is very high.

The railroads are a good example of what can happen to an industry that at one time seemed secure, so secure in fact that some companies issued perpetual debenture stock. There is probably a lesson in this for testators who are founding trusts that will be of long duration. They should give to their trustees discretion as to investments. In one case the writer remembers, the only discretion given was to invest in the stock of a certain railroad which in the testator's lifetime was reckoned one of the blue chip investments.

In the hectic days of 1929 it was not unusual for stocks to sell at fifteen or sixteen times their most recent earnings. Only on the assumption that earning power could be largely increased, was the price justified. The unwisdom of using such a high multiple of earnings to reach a capital value has since been amply demonstrated.

There are other methods of arriving at the capital value

of unlisted stock besides taking a multiple of the earnings. In the Province of Quebec the method adopted in valuing stock of an industrial concern is to ascertain the value of its net assets by appraisal and otherwise. Next, the average earnings for, say, the past five years are ascertained and these are capitalized on a six per cent basis. The two values thus attained are added together and divided by two. The result is the value of the stock.

This method of valuation seeks to determine the goodwill on the assumption that earnings in excess of 6% on the assets produce goodwill, if by goodwill super profits are understood. A little reflection will show that while this method develops goodwill, when it is a plus quantity or positive, yet, if fairly employed, it should equally develop minus or negative goodwill. So far as is known, the existence of negative goodwill has not been conceded. Yet it should logically exist, and just as there are plus and minus quantities there should also be positive and negative goodwill. At this point it will probably occur to the reader that what all this amounts to is that earnings are being capitalized and that the value of the net assets is adjusted to the capital value so ascertained and that this adjustment is called goodwill. If the earnings are less than 6% then the value of the net assets alone, ascertained by valuation, is taken. This divided by the approximate number of shares, if the capital consists of common stock alone, will give the value per share.

In these days when taxes absorb such a large proportion of the earnings of a company, 6% before taxes on the capital invested seems much too low. As it is only the amount after taxes that is available to shareholders, all the arguments that income tax is not a charge against profits lose their force when applied to the case of the holder of common stock. The taxes under our system of taxation are paid by the common stock holder.

When a company in Quebec has to pay out a minimum of 35% of its earnings by way of income taxes, less than 4% is left if earnings are assumed to be 6%. Such a company, if it had to pay 7% on a preferred stock issue and provide, perhaps, a sinking fund for bond redemption, would find difficulty in so doing.

Most of the valuation cases that have come before our

courts have been unreported and, so far as known in the Province of Quebec when reported, no indication has been given of the formula employed to ascertain the value of the stock. One has to look as a rule to the United States for guidance. Most differences of opinion on the question of valuation seem to be settled amicably in England. The tax authorities, it is understood, are usually willing to accept a certificate from the secretary of the company stating the last price at which a sale took place unless there is any material change of circumstances.

There have been a considerable number of American cases on questions of valuation and these will be found, with appropriate comments, in the monumental work by Professor Bonbright on the valuation of property. The classic case cited by Professor Bonbright which illustrates the principles of valuation of an unlisted common stock is that of the Ford Motor Company. In 1919 certain minority stockholders were approached and asked to sell their stock to Henry Ford and his son. If the stockholders sold and the sale price was higher than the value of the stock at 1st March 1913, owing to the taxation of capital gains, the vendor would have to pay income tax. The significance of 1st March 1913 is that it is the basic date for income tax, just as our basic date is 1st January 1917. To determine the amount on which tax would be payable it became necessary therefore to ascertain the value of the stock of the Ford Motor Company at 1st March 1913. Taking advantage of existing procedure application was made on behalf of the purchasers to the Commissioner of Internal Revenue to fix the value of the stock at 1st March 1913. Following on this the value per share was fixed by the Commissioner at $9,489.34. It is interesting to note that in arriving at this value of $9,489.34 per share the earnings assumed were capitalized on a ten per cent basis. The assumed earnings were the average of the actual earnings for 1912 and an assumed figure for 1913 based on the actual earnings for the months of January and February 1913.

The reported earnings of the company were:

1906	$ 175,000.00
1907	1,001,000.00
1908	1,168,000.00
1909	3,176,000.00
1910	4,145,000.00

1911	7,541,000.00
1912	14,119,000.00
1913	26,651,000.00
1914	26,341,000.00
1915	38,199,000.00
1916	54,606,000.00
1917	29,726,000.00
1918	56,513,000.00

The number of shares of capital stock was 20,000.

In 1925 the United States treasury department reviewed the assessment and decided that the value of the shares of the Ford Motor Company at 1st March 1913 was not \$9,489.34 per share but \$2,634.00 per share, and that further tax was payable. In the face of the objections received, the department revised its figure and increased the value per share to \$3,547.84. This last figure was arrived at by taking the average annual earnings for the period from 1st January 1909 to 28th February 1913. From this was deducted 8% on the net tangible assets. The remainder was capitalized at 15% and added to the value of the tangible assets. Dividing this figure by 20,000—the number of shares—gave the figure of \$3,547.84.

On the appeal of one of the taxpayers the question of value came before the board of tax appeals who determined that the value of the shares was \$10,000 per share. In rendering their opinion the Board stated:

> The problem of valuation of the common stock of a closely owned manufacturing corporation has not yet been developed so far that any particular method of reasoning in respect of it is authoritative or any particular class of persons may be recognized as experts.
>
> Primarily the earnings are the test of success of the past and the indication of the future. The other statistics of production, sales, etc., and the description of the management and its methods and plans serve to give depth and perspective to the earnings. Such other facts help to indicate the safety with which the earnings may be relied upon as indicating a normal or healthy condition. They are significant not of their own weight or force but only in their relation to earnings.
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> We are of opinion that the fair market price of the stock owned by this petitioner in the Ford Motor Company on 1st March 1913 was at the rate of \$10,000 per share. While we have not arrived at this value by the application of any mathematical formula, because we believe there is no authoritative formula available, we have given careful consideration to the several methods suggested in the course of the trial and have not been unmindful of the aid to be derived from the use of such tests.

One problem affecting the valuation of the stock of unlisted companies seems to have been solved. Until within a year or two ago it was a serious question whether, when the by-laws of a private company gave the other shareholders a right of pre-emption at a fixed price, that the fixed price was the value of the stock. The question came before the courts on various occasions and the judges were practically equally divided. Not until the Crossman case reached the House of Lords could the question be said to be settled. By a majority decision in that case it seems to have been decided that the right of pre-emption does not limit the value of the stock.

As has been said, it is impossible to enumerate all the factors that have a bearing on the valuation of a stock in particular cases. Obviously some will be of greater importance than others and only the experience of the accountant will enable him to decide the relative importance of each. One factor which is present as a rule, and in most valuation cases assumes the greatest importance, is the earnings factor. The ascertainment of the normal earning power as a factor, and its proper employment when derived, is peculiarly the domain of the accountant. It is with that factor that this article has sought mainly to deal.

RECENT CHANGES IN THE OPERATION OF FOREIGN EXCHANGE CONTROL IN CANADA

By M. W. Mackenzie, Chartered Accountant, Ottawa

IN the April 1940 issue of THE CANADIAN CHARTERED ACCOUNTANT, Mr. Walter Gordon described the operation of foreign exchange control in Canada. The purpose of the present article is to outline the principal changes that have taken place in its operation since that time.

Before dealing with these changes however it may be well to review the subject as described by Mr. Gordon. He pointed out that, prior to Canada's declaration of war, practically all the important countries of the world, with the exception of the United States, had introduced exchange control. He went on to outline the problems facing the Canadian authorities as a result of war conditions, mentioning in particular the large foreign investment in Canada and the possible effect on this country's economy of a sudden flight of capital, as well as the need of husbanding exchange resources to pay for vital war imports. He then described the general plan of control, stressing the importance of receiving foreign exchange in respect of all exports and of limiting the kind of exchange that could be used in respect of imports; in this connection he referred to the use made of export and import documents to ensure compliance with the Board's requirements and touched on the special plans developed in order to facilitate the carrying on of ordinary commercial transactions. The article proceeded to outline the general policies adopted in the application of control regarding such matters as the provision of foreign exchange for the withdrawal of the income on capital invested in Canada by non-residents—in particular the payment of dividends to non-residents—and the general requirements placed on residents regarding foreign cash and securities which they owned at 15th September 1939.

Another factor which was taken into account in the decision to introduce exchange control into Canada was the fact that we would no longer be able to settle our favourable trade balance with the United Kingdom through foreign markets. On 24th June of this year the then

Minister of Finance in his budget speech described this additional important factor. He said in part:

> In normal times we are able to use any excess receipts from our trade with one country to meet any deficits in our trade with another. At this time, however, when Britain has such vital need of gold and United States dollars to purchase planes and other war equipment, we cannot expect her to settle all her trade balance with us in gold or foreign exchange. Consequently, while there has been, since the war began, a substantial increase in our favourable balance of trade with the United Kingdom, a very large proportion of the surplus sterling exchange which we obtain and which formerly we were able to convert into United States dollars in order to meet any adverse balance of payments with that country can no longer be so converted.

Foreign Exchange Acquisition Order

Probably the outstanding development in the operation of the control in recent months was the enactment on 30th April of the Foreign Exchange Acquisition Order, 1940. This order required all residents of Canada, with a few exceptions, to offer for sale to authorized dealers of the Foreign Exchange Control Board their holdings of foreign currencies. The exceptions covered the maintenance of working balances by commercial and other companies and took care of such cases as residents acting as trustees for non-residents, but speaking generally it included all individuals, corporations and institutions in Canada, including the chartered banks, the Bank of Canada, insurance companies and trust companies.

It should be noted that the Foreign Exchange Control Order had only required the sale of foreign exchange coming into the possession of residents after 15th September 1939 although residents who held cash balances at that date could not disburse them without the prior approval of the Board; generally speaking such approval was given only for purposes for which the Board would sell foreign exchange.

In the operation of controls in most other countries the taking over of cash balances has been simultaneous with the enactment of the Control Order. By delaying the acquisition of foreign currency balances in Canada, the impact of the new conditions resulting from exchange control was lessened and time was given for the necessary readjustment.

Many of the foreign cash balances held by residents, both companies and individuals, were maintained as reserves, having in mind the probable requirements of the

resident concerned. The Acquisition Order had the effect of merging all such reserves so that a uniform policy determined by those in possession of a full knowledge of the facts could be applied. It is perhaps not fully appreciated that the resident who in the past had held what he considered an ample reserve of United States funds for his own needs, in fact had his position strengthened by the Acquisition Order. The effect of this order was that the total exchange resources of the country were made available to provide for any resident with a legitimate requirement. Furthermore, as a resident was not entitled to dispose of his balances prior to the Acquisition Order without the approval of the Board, the routine of making disbursements was not substantially altered.

One of the principal exceptions provided in the Acquisition Order was the permission given to companies to retain working balances necessary to meet day to day requirements. In theory, it might be argued that a working balance should have been established on an individual basis for each company, taking into account its estimated income and outgo in each currency. This, however, would have presented an unpractical situation having in mind the large number of companies which, for one purpose or another, have been given authority to operate foreign currency bank accounts. To meet the situation a general yardstick was established setting an amount not in excess of contractual commitments payable in foreign currency and maturing within ninety days, as the working balance which a company might hold. Needless to say, a general rule of this nature does not meet the needs of all companies concerned and for this reason working balances, calculated on other bases but observing the same general principle, have been determined in a number of cases.

Provision was made in the Acquisition Order for reciprocal agreements with other countries respecting the application of exchange control restrictions to their respective nationals; in accordance with this provision an agreement was entered into between the Dominion Government and the United States Administration.

Many of the United States nationals resident in Canada came to this country in connection with the operations of the subsidiaries of United States parent companies and are

here on a temporary basis although they may remain in Canada for a number of years.

Quite early in the operation of the control this situation was recognized and the Board had, in a number of cases, granted exemptions of specified assets where it could be shown that such assets had been accumulated by the applicant entirely apart from his Canadian activities. Under the agreement it is now formally established that United States nationals who are not British subjects can, upon establishing their status with the Board, obtain exemption in respect of their United States assets. In general, once this exemption has been granted the Board does not provide further amounts of foreign exchange to such individuals. An exempted foreign national however is not entirely relieved of exchange control restrictions and, for example, is not permitted to buy Canadian dollars except in Canada.

Taxation Changes

The budget speech delivered by the Honourable J. L. Ralston on 24th June proposed two measures designed primarily for the conservation of foreign exchange, although they did not directly affect the administration of control. The first was a war exchange tax of 10% on all imports, free and dutiable, from non-Empire countries, while the second was a steeply graded tax to replace the existing 5% excise tax on new passenger automobiles. The primary purpose of both these taxes was to save exchange, while the second measure had the additional effect of releasing productive capacity for war purposes without dislocation of industry.

Travel for Pleasure

Another development of major importance took place on 5th July 1940 when the Minister of Finance announced that restrictions would be placed on the provision of United States funds for the purpose of pleasure travel in countries outside of the sterling area in order to conserve the nation's supply of United States dollars for the purchase of war supplies and other vital needs. The administration of this governmental decision has naturally fallen on the Foreign Exchange Control Board and it is probably safe to say that no other policy has come so close to the personal problems of individual residents.

It has been estimated that in the past Canadians have

spent as much as 75 million dollars in a single year on pleasure travel in the United States. The importance of this sum to the national economy is obvious under any circumstances, but translated into terms of guns, tanks and aeroplanes it assumes vital significance. Furthermore, the part that Canada is to play in financing the Empire's war effort will and should call for sacrifices on the part of our residents. Even if we were permitted to borrow in the United States market it can be held that we should not increase our foreign debt until we have tightened our belts in foregoing such personal pleasures.

The application of this policy of restricting pleasure travel while at the same time providing exchange for health and business travel presents difficult administrative problems. The Board has had, of necessity, to scrutinize carefully all applications for health travel and, as far as possible, to limit the amounts of exchange provided for business travel. Towards this end an application for exchange for health travel has been designed to include a full medical certificate, while companies are asked to budget their requirements for business travel and to keep expenses to a minimum.

United Kingdom Residents in Canada

The problems presented in financing evacuees from the United Kingdom have probably been as much in the public eye in recent months as any other question resulting from exchange restrictions. The situation is not fully understood in Canada, and many people seem to believe their difficulties result from regulations or policies determined by the Canadian Foreign Exchange Control Board. The fact of the matter is that the situation results from the application of the regulations of the United Kingdom Exchange Control as they apply to their own residents. Most people fail to realize that Canadian dollars to the United Kingdom authorities are just as important as United States dollars are to us.

The United Kingdom is buying huge quantities of materials and supplies in Canada which can be paid for only by the proceeds of her exports to Canada, the repatriation of Canadian securities held in England (which can only be done within the limit of this country's capacity to re-

patriate) or by the provision of gold or United States dollars.

In the determination of policy the United Kingdom authorities neither provide Canadian dollars for the support of evacuees nor sanction their use by those residents who happened to be in possession of Canadian dollars at the time exchange control came into force. As in the case of the Canadian control, all foreign exchange coming into the possession of residents of the United Kingdom, and foreign exchange in this case includes Canadian dollars, must be turned over to the Control authorities. Other Canadian dollar assets, such as securities, must be held subject to the regulations and available for requisition.

Under these circumstances all applications for Canadian dollars to be paid to or for the support of evacuees are refused if such Canadian dollars would otherwise accrue to a resident of the United Kingdom. It may be noted that an individual who was resident in the United Kingdom in September 1939 continues to be considered as a resident notwithstanding that he has moved to Canada or elsewhere, just as the reverse situation exists in Canada and other parts of the Empire.

Transactions with Continental Europe

On 7th June the Prime Minister announced the completion of a payments agreement with France covering transactions between Canada and the French Empire. Until that time the Board had confined its dealings in foreign currency to United States dollars and sterling. Any other currencies which residents of Canada might have occasion to use were acquired or disposed of by the Board's authorized dealers in New York or London but the transaction was translated to United States dollars or sterling as far as the Board itself was concerned. Under the agreement with France, buying and selling rates for the franc were established and machinery was provided to place all exports and imports with any part of the French Empire on a franc or Canadian dollar basis. The agreement is now of historical interest only, as dealings in francs were suspended on the collapse of France, which came within ten days after the completion of the arrangements.

With the entry of Italy into the war and the collapse of France it was felt desirable to place further restrictions on transactions between residents of Canada and residents

of neutral countries in continental Europe in view of the obvious danger of remittances to neutral countries falling into enemy hands. Consequently, all applications are required to be submitted to the Board where they are carefully scrutinized. In general, interest and dividends on securities owned by residents of continental Europe are permitted to be placed to the credit of the owner of the securities in a Canadian dollar account.

United Kingdom Regulations

The United Kingdom authorities have recently extended to Canada their control of payments for their exports and have also placed all dealings with the United States and certain other countries on a registered account basis. These steps have had a significant bearing on the operation of the Canadian control.

In March 1940 the first steps towards export control were introduced by the United Kingdom authorities when a list was issued of commodities which could only be exported to points outside the Empire against payment in United States dollars or other hard currency. The list, however, only specified whiskey, tin, jute, rubber and furs. In September all exports from the United Kingdom were placed under control to ensure, by one means or another, the receipt of hard currency.

During the month of July the arrangements for registered accounts were announced with the principal effect of preventing any transfers of sterling except those between residents of the same country. For example, a resident of the United States cannot now pay sterling to a resident of Canada and the reverse transaction can only be made with the prior approval of the Canadian Foreign Exchange Control Board.

Sterling required for the payment of exports from the United Kingdom to the United States can only be obtained through the medium of a registered account, while sterling issued in payment of imports into the United Kingdom from the United States is known as "registered" sterling and is freely convertible into United States dollars at official rates. The direct result of these changes has been that the Canadian Control can relax to some extent its vigilance over sterling transactions.

Enforcement

It has been the experience of the Board that the great majority of residents recognize that exchange control regulations are necessary as an integral part of the war effort. At the same time, there are the inevitable few who attempt to carry out transactions contrary to the regulations of the Board for the sake of personal gain.

In the early days while the officers of the Board were feeling their way and while members of the public could with some justification plead ignorance of the principles involved, a certain latitude in the interpretation of the regulations was both necessary and desirable. There is truth, however, in the legal maxim, "hard cases make bad law" and in the long run it is essential that a consistent policy be set and followed, otherwise those who comply strictly with the law are placed at a disadvantage vis-à-vis those who do not take the trouble to ascertain their position or are guilty of wilful wrongdoing. It may be said that the Board will prosecute to the full extent of the law any case, which comes to its knowledge, of a deliberate attempt to defeat the purposes of exchange control. Persons guilty of such offences are committing direct acts of sabotage against the State.

Administrative Organization

The foregoing are the principal developments in exchange control during the last few months. Reference must be made, however, to a substantial rearrangement of the administrative organization which took place during June and July. It must be remembered that exchange control was introduced within a week of our declaration of war. Detailed plans for the establishment and operation of the Board had been prepared in advance in case they should be needed but the control, while embodying certain underlying principles of other exchange controls, was a new system introduced in a country that had not previously faced any exchange restrictions. The application of this theoretical control to actual cases called for numerous important policy decisions, and in order to maintain consistent treatment of the hundreds of applications and queries that were received daily, the administrative organization was designed on a procedural basis. This gave the "24 hour experts" who came to Ottawa to help, an opportunity to

specialize in a particular type of procedure such as the technique of handling foreign currency bank accounts; but it carried certain disadvantages. After the control had been in operation for some nine months it was possible to arrange the organization, which of necessity had grown too rapidly to allow of much planning, on a more permanent basis.

The new plan divided the main body of the organization into two divisions which are known respectively as "Approvals" and "Administrative." The former is the division with which the public comes most in contact as it deals with the day to day applications for exchange. The Administrative Division on the other hand is composed of the foreign exchange advisor, the secretary's department, the statistical, public relations and enforcement sections as well as the examination and settlement sections which are responsible for the scrutiny of the completed individual forms as well as the necessary settlements with the chartered banks acting as authorized dealers. The Investigation Section is also grouped in the Administrative Division. This section carries out the field investigations of permit and licence holders who have authority to handle certain types of transactions without prior reference to the Board or its authorized dealers.

The Approvals Division is divided into eleven sections. With one or two exceptions, such as the section which deals with all applications for the payment of interest and dividends, each section is established to deal with a particular type of applicant, rather than type of application. There is, for example, a "Securities Section" dealing with the problems of stockbrokers, investment dealers and the private investor; an "Insurance Section," a section described as "Trusts and Agencies" whose principal concern is the problems of executors and trustees, be they individual or corporate. Industrial and commercial, as distinct from financial companies are dealt with by five sections—Primary Industries (covering mines, fisheries, lumbering, the grain trade and generally the development of natural resources); Manufacturing; Merchandising; Shipping; and Services; the last section dealing with such matters as transportation other than shipping, communication and organizations dealing in services rather than goods, such as advertising.

The two remaining sections are Travel, organized pri-

marily to deal with the situation resulting from the restriction of pleasure travel, and the General Section which, as its name implies, deals with all applications which do not fit naturally into the other sections.

This rearrangement has already proved helpful to the public and has provided a more satisfactory basis of internal organization.

ANNUAL MEETING OF AMERICAN INSTITUTE OF ACCOUNTANTS

Editor's Note—Mr. W. G. Rowe, C.A., President of The Dominion Association of Chartered Accountants, was the Official Representative of the Association at the 1940 Annual Meeting of the American Institute of Accountants. For the information of members of the Association his report is published this month.

THE fifty-third annual meeting of the American Institute of Accountants held at Memphis, Tennessee, from Sunday, 13th October to Friday, 18th October 1940, comprised a series of meetings and social events which were crowded into the allotted time only by the expedient of timing simultaneously more than one meeting or event. Sunday and Monday were devoted to committee and council meetings and social events, the first general session of members taking place on Tuesday morning. The next and final sessions were held on Friday, the intervening periods being filled with round-table discussions and other meetings, luncheons, special events for ladies and evening entertainment.

The topics chosen for round-table discussion were devoted to such matters of general interest as professional ethics, auditing procedure and research, progress in accounting education and internal conduct of accounting practice, with such special subjects as audits of building and loan associations, reports of municipal bodies, accounting for contractors under State Highway Department contracts, accounting for the oil industry, etc.

Several topics in which I was most interested were under discussion at the same time and the effort to divide one's time between several simultaneous meetings was not entirely satisfactory. Nevertheless, I was amply repaid for the time given to the various discussion meetings, all

of which appeared to have been well planned in advance and were generally characterized by full and free discussion.

Papers on a variety of live subjects were read and followed by open discussion of them. As was natural, many of the subjects considered and discussed related to laws and regulations affecting accounting practice in the United States only. Our professional brothers to the South are beset with many risks, restrictions and difficulties from which we in Canada are, perhaps, thankful to be free. At the same time, one should not overlook the fact that the greater the demands made upon one's faculties and capacities the greater the effort to meet those demands. Thus, it may well be that we are the sufferers, in comparative attainment, through too easy an environment.

To my mind, the principal matters dealt with at the convention related to the education of the public accountant, extensions of auditing procedure and professional ethics. But in order for us in Canada to understand fully the work and aims of the American Institute, its difficulties and its handicaps, it is necessary to appreciate the difference between the laws under and by means of which the profession was created and functions in each country. Briefly the difference may be indicated by pointing out that whereas in Canada, as in other British countries, chartered accountants are thus exclusively designated under a charter from the Crown granting them a corporate existence with the right to prescribe membership qualifications, standards of technical education and practice and a code of professional ethics, in the United States each certified public accountant is individually licensed to practise as such by the State after passing certain examinations set by the State and in some States after having had a certain period of practical experience in the office of a practising certified public accountant, subsequent to passing the State examinations. While the examinations may be earlier taken and passed, no certificate is issued until the service requirement is fulfilled, where such service is necessary. In this connection it should be noted that uniformity in examinations is secured by use in forty-four (of the forty-eight) States, on the same day, of the same examination papers, all set by the American Institute. This uniformity is perhaps one of the most notable achievements of the Institute, considered in the light of its inevitable and cumulative effect upon

professional education and practice. In many States the papers are sent to the Institute for grading.

The Provincial Institutes of Chartered Accountants in Canada are empowered by statute to regulate all matters relating to the profession and to control and direct the practice and conduct of members. In the United States the Societies of Certified Public Accountants are private associations formed by those who have been licensed by the States to practise as public accountants and membership is, therefore, voluntary and not compulsory. The rules of practice and conduct set by these Societies are applicable only to members and any member wishing to escape its discipline may terminate this membership in the Society at any time without affecting his right to practise as a certified public accountant. In Canada no one may describe himself or practise as a chartered accountant unless he is a member in good standing of one of the Provincial Institutes.

The Dominion Association of Chartered Accountants is a body created by charter from the Dominion of Canada (the Federal Government) whose membership consists of all members in good standing of the nine Provincial Institutes.

The American Institute of Accountants consists of those who qualify as members by its own rules as to examination, etc., but membership is not limited to certified public accountants only, for while they form, naturally, the great majority of the membership, under former regulations, now changed, a number of chartered accountants living in the United States were admitted to membership. Since 1st January 1936 all new members of the American Institute have to be certified public accountants. The number of certified public accountants in the United States is said to exceed 20,000, while the present membership of the American Institute is about 6,000.

The importance of education and examinations in the eyes of the American Institute is indicated by the consideration given these subjects at meetings of the special committee on students' societies of the Certified Public Accountant Examiners and Institute Board of Examiners and at round-table discussions on progress in accounting education. The many phases of education dealt with in special

papers read and in discussions by instructors, examiners and practising members are evidence of the effort being made to fit the accountant-student for his work by academic and practical training. As an instance of progress in this direction may be mentioned the qualifications for the C.P.A. degree now required by some States, (e.g. New York) which consists of a four-year college course in certain accountancy subjects followed by three years' experience in the office of a practising certified public accountant. It is interesting to note here this effort to supply the C.P.A. student with the combined theoretical and practical training which is received by the chartered accountant student under articles. But while it would be still more interesting to know which system is capable of producing the better accountant, a basis for any proper or fair comparison as to results is not at present available. The idea of apprenticeship, one gathers, is not popular in the United States and some certified public accountants consider that our system of articles is a device for obtaining cheap labour. Nevertheless, no satisfactory system appears to have been found so far which will or can supply the required combination of theory and practice for the student-in-accounts in place of the well-established and tried system of service under articles for some adequate period.

The complaints heard during the discussions on academic attainment as to the low standing of college students in English and mathematics sounded quite familiar. As in Canada, the blame for this shortcoming was laid upon the public and high schools. I was glad to be able to point out that in the case of at least one Provincial institute this defect was being cured by special courses and certain minimum pass marks required in these subjects.

The time allowed candidates on accountancy examination papers was another subject discussed on a suggestion that the present period of six hours be extended to eight hours. No action was taken on this, but the matter is of interest in view of the time allotment of four hours in our uniform intermediate and final examinations.

Among many subjects relating to public practice covered by papers and discussions those dealing with inventories, accounts receivable, internal check and control and generally with the application of extensions of auditing procedure were particularly interesting and informative,

illustrated as they frequently were by instances from actual practice. It is difficult for us in Canada, perhaps, to understand and sympathize with the profession in the United States in its recent extensions of auditing procedure unless we realize the power, influence and effect upon the business world there of such statutory bodies as the Securities and Exchange Commission and of the constant threat to the standing of the profession through possible governmental regulation. The untiring energy and good judgment of outstanding members of the American Institute in co-operation with government departments and officials have done much to advance the confidence of the public in the profession. Important strides have been made in the technique of accounting presentation with a view to facilitating reading and correct interpretation by the public, but this is perhaps one of the most difficult problems confronting the profession, no complete and satisfactory solution of which is in sight. It is recognized that the ignorance and carelessness of the average investor coupled with the technical and inherent limitations of financial statements and audit reports thereon are hard to reconcile and can be eliminated, if at all, only by education on the one hand and on the other by study, skill and evolution of thought and practice.

The spontaneous and hearty welcome afforded visitors by the Tennessee Institute and the hospitality and delightful social entertainment provided left nothing to be desired. I should like to make special acknowledgment here of the marked attention and recognition accorded me as President of the Dominion Association and of the many courtesies and proofs of friendship extended to me as a Canadian. The policy of the Council of the Dominion Association of sending an official representative to each annual meeting of the American Association is greatly to be commended and those who, like myself, have been favoured with the privilege of such representation can attest to the very real appreciation of this act of friendship on the part of our Association.

At the opening of the general sessions on Tuesday morning I was invited to the platform by the President and, being accorded an opportunity of acknowledging my introduction, I conveyed the greetings of our members to the American Institute and expressed my sense of good fortune in being privileged to attend a convention at which there were present so many recognized authorities and masters

in our profession. At other meetings during the week I was courteously permitted to take part in the discussions and at the closing banquet on Friday evening, I was allowed to say "thanks" and "farewell."

One other Canadian accountant was present at the meeting at Memphis, Mr. J. G. Mundie, of Winnipeg, Manitoba, a past President of the Dominion Association.

(Signed) W. G. ROWE.

Vancouver,
2nd November 1940.

THE REPORT OF THE SIROIS COMMISSION*

By Professor J. A. Corry, Kingston, Ontario

I

The Royal Commission on Dominion-Provincial Relations, or the Sirois Commission, as it has come to be known,[1] was appointed in August 1937 to make a far-reaching inquiry. It was asked to re-examine "the economic and financial basis of Confederation and the distribution of legislative powers in the light of the economic and social developments of the last seventy years." In more detail, it was instructed to consider whether the present division of powers and responsibilities between the provinces and the Dominion was adequate to meet the present and prospective demands for governmental action, to investigate the working of federal subsidies and grants to provincial governments and to study the equity and efficiency of the Canadian taxation system as a whole. Guided by the light of its researches, it was to go on to recommend what financial and constitutional changes, if any, it thought necessary to restore and maintain health and efficiency in government at the municipal, provincial and national levels. The only ex-

*This is the first of three articles to be prepared by Professor Corry on the Report of the Royal Commission on Dominion-Provincial Relations; the second article will be published in the January issue. Professor Corry is Professor of Political Science at Queen's University.

[1]The Hon. N. W. Rowell, Chief Justice of Ontario, was the first Chairman of the Commission. When ill-health unfortunately compelled him to retire, Dr. Jos. Sirois, one of the members of the Commission, was appointed Chairman.

press limitation on the scope of this inquiry into public finance and the constitutional division of powers was that the solution should be found within the framework of the federal system. But, broadly speaking, the working of the federal system since Confederation was placed under review.

The Commission took its instructions seriously and spent considerably over two years on its task. Public hearings were held in the provincial capitals where the provincial governments submitted carefully documented briefs, explaining their difficulties—and their grievances where grievances were thought to exist. Associations representing substantial interests and sections of opinion were encouraged to put their knowledge and views at the service of the Commission and a multitude of organizations ranging from the Communist Party to the Canadian Manufacturers' Association presented submissions. Dominion and provincial civil servants and eminent foreign authorities on the questions involved gave evidence before the Commission. More than twenty special investigations relating to vital aspects of the inquiry were conducted by experts on behalf of the Commission.

The Commission deliberated on the voluminous materials thus gathered and its report was made available to the public in May 1940. The Report fills three large volumes. Book I is a history of Dominion-provincial relations since 1867 which aims to explain how Canada got into the position which precipitated this inquiry in 1937. Book II sets forth the recommendations with reasoned justification for the conclusions reached. Book III is a condensation of statistics on public finance (Dominion, provincial and municipal) gathered in the course of the inquiry. By the adoption of a uniform classification of revenues and expenditures, the public accounts of the Dominion, provincial and municipal governments have been put on a comparable basis and Book III shows in some detail how the adoption of the Commission's financial recommendations would affect the provinces and the municipalities. These statistics are available in extended form in an appendix to the Report and will be indispensable to anyone who has to work with the Public Accounts in the future. In addition, there are fifteen other appendices in printed or mimeographed form. These contain the results of the special studies which the Commission found most useful for its purposes. In the volume of its

printed material, if in nothing else, the Commission did justice to the importance of its task.

The Commissioners state that the unanimous recommendations which they finally reached differ widely from the views held by any one of them at the outset. They say that as they came to appreciate more fully the difficulties in which the Canadian federation is now involved and to consider how Canada had got into this awkward position, they were led to conclusions which they had not at first anticipated. Accordingly, they plead that judgment on the recommendations should not be passed until the facts which the Commissioners had before them are grasped and the implications of those facts are understood. It is necessary, therefore, to consider their analysis of our present troubles and how we incurred them before turning to the proposals for extricating ourselves.

Present Troubles Analyzed

This analysis of our troubles is to be found in Book I of the Report. All Canadians are familiar with the outward symptoms. Since 1930, the provinces and the municipalities have not been able to meet their responsibilities with their own resources. The provinces had to come to the aid of the municipalities and then the Dominion had to succour the provinces with grants which have reached huge proportions. It will be recalled that the financial settlement at Confederation provided for federal subsidies to the provinces to enable them to balance their budgets. In 1874, the annual total of these subsidies was less than $4 millions. After repeated upward revisions, the annual amount had passed the $20 million mark by 1937. But these subsidies which are provided for in the constitution are only a small part of present federal assistance to the provinces. Dominion grants for old age pensions have now reached $30 millions a year and are growing rapidly. Between 1930-7, the Dominion made emergency grants to the provinces for relief totalling almost $300 millions. In this period, the Dominion had to pay about 40% of the money cost of relief, as well as provide substantial loans to some provinces. To put it briefly, the financial settlement agreed on at Confederation has broken down completely.

The financial breakdown has been accompanied by serious political strains. The grants for relief and old age

pensions are so large that the Dominion has felt compelled to try to control the spending of them. But giving money away and then trying to direct its expenditure is only less popular than refusing to give it in the first place. This situation has caused continual friction between the Dominion and the provinces. The friction has been intensified by the fact that there are no fixed principles for calculating how much total assistance each province should get. The only basis for calculating the large relief grants has been the extremities of the provincial governments. Naturally, each province takes a darker view of its difficulties than do the Dominion and the other provinces. The resulting disputes are deepened by odious comparisons with the treatment given other provinces. The richer provinces in the centre become alarmed lest they become "milch cows" for the poorer outlying provinces and they lash out at the milkman, i.e., the Dominion government. The confusion in public finance along with the almost insuperable difficulty of getting any co-ordinated attack on the problems of the depression have been the main causes of the open discord between the governments in the federation in recent years. The serious gaps between the responsibilities of the provincial governments and their financial capacity threaten to undermine the whole structure of Canadian political unity. The closing of the ranks to meet the shock of war obscures but does not close the fissures beneath.

Why Drastic Remedies Needed

The Commissioners had to decide whether the disruption of the financial settlement made at Confederation is a minor and passing malady or whether it springs from deep-seated causes calling for drastic remedies. There are four main steps in the reasoning which led them to the latter conclusion. These are, first, the great economic changes which have been brought about by seventy years of national development; second, the remoulding of the patterns of social life by the transformation in the economy; third, the remarkable expansion in government activities and responsibilities following upon economic and social change; fourth, the distribution of these new responsibilities between the provinces and the Dominion by the British North America Act as interpreted by the Privy Council. Each of these factors requires careful attention because the wisdom of the

main recommendations hinges on the correctness with which the Commission weighed them.

Economic Changes Since Confederation

It is not necessary to dwell on the extent of economic change since Confederation. The colonies united in 1867 were made up mainly of a number of agricultural and village communities which practised perforce a high degree of self-sufficiency. Trade with other communities and other countries was an important factor in the level of prosperity and there were rosy visions of the extended trade which the railways would make possible. But each community provided for itself most of the plain necessaries of life. Self-sufficiency went even further because the pioneer farm was a model of economic autarchy. Within the limits imposed by nature, the farm family controlled its own destiny. The fluctuation of prices and the ups and downs of international trade could not deprive it of food, clothing and shelter.

The establishment of free trade between the separate colonies, the building of extensive transportation facilities and the great growth of international trade changed all this. Led on by a world demand for the products the country was admirably suited to produce, the new nation rapidly became a nation of specialists. Abandoning the old self-sufficiency of families and communities, Canadians committed themselves deeply to the international division of labour. The result was not only one-industry towns but great one-industry regions as wide or wider than provincial boundaries.

Canada became the world's greatest exporter of wheat, newsprint and base metals and moved to front rank for other commodities as well. When international trade booms, great prosperity is the reward for having left self-sufficiency behind. When international trade languishes, heavy penalties are exacted because it is impossible to return to it. Many communities, indeed whole regions, are exposed to destitution because international demand for their products has fallen away through circumstances they are powerless to control.

Parallel with the ever-growing dependence on the international market came increasing interdependence at home. Encouraged by a protective tariff, Canadians who were not engaged in the export industries specialized in supplying goods and services for the home market. This development

reduced still further the self-sufficiency of families and communities. The great majority of the population became dependent upon one another and upon a high level of economic activity for a livelihood. And, to use the words of the Commission, the exporter's dollar was the lifeblood of the economic system when the world depression broke in 1930. With the drastic cut in the exporter's income, distress deepening rapidly into destitution in many areas swept across the country.

Social Changes Since Confederation

The development of the Canadian economy brought marked social changes—the second step in the Commission's analysis. The most important feature of these changes has been the movement from the country to the city—the shift from rural agricultural to urban industrial conditions of life. It is calculated that in 1871, 80% of the people lived on the farm or close to it while by 1931 the proportion had declined to 46%. Of this 46%, about one-quarter lived on the prairie where it is impossible to practise the self-sufficiency of the pioneer farm of 1871. Also, in 1931, two-thirds of all those at work in the country were wage-earners, reflecting the predominance of industrial employment for wages over the older state of affairs where the small proprietor working on his own account was the rule.

In the days of the pioneer farm, the family absorbed much of the shock of individual misfortune. When one member of the family became too old to work or was disabled, the family supported him. Sons who had sought employment or business opportunity elsewhere returned to the homestead when disaster overtook them and waited for new opportunities to appear. This mutual insurance society was a success because the family, based on the farm, was a fairly complete economic unit. It still works on the present day farm insofar as the farmer has not become a specialized producer dependent for his income on distant and uncertain markets.

Under urban industrial conditions, the situation is entirely different. Instead of the individual relying on the family, the family is almost entirely dependent on the individual, the wage-earner. When his wage or salary disappears, the whole family is soon in distress. The result is a

persistent drive to enlarge the unit of mutual insurance beyond the family. There are no doubt several ways of doing this; the private enterprise of insurance companies is one of them. But in every industrial country, the tendency has been to make one or other of the units of government the unit for absorbing the shock of a variety of its individual misfortunes. Unemployment relief and insurance, old age pensions, mothers' allowances, a wide range of public welfare services have become costly functions of government.

Expansion of Government Activities

This is the third step in the Commission's analysis. Economic and social change has brought about a great expansion in the responsibilities of government. The steep rise in public expenditures is largely due to governments taking over functions which were formerly performed by the family and by private charity. The unit for supplying public welfare services might be the municipality, the province or the Dominion. The existence of so many highly specialized communities limits the possibilities. In the one-industry town and the wheat growing municipality, adverse economic conditions affect the livelihood of all and as the need for public assistance grows, taxable capacity falls. While some municipalities are impoverished, others escape through the capricious incidence of depression in a complex economy. But in any case, as long as municipalities are practically restricted to taxes on real estate, they cannot carry the burden of a wide range of public welfare services. Experience has already shown that, for most services, the unit should be larger than the municipality. In a country as highly specialized as Canada, with great regions dependent on a single industry exposed to fluctuations in international trade, even the province is not a large enough unit for all purposes. Some of the risks associated with the operation of the highly vulnerable Canadian economy in a disturbed world must be spread as widely as possible. That is to say, there was no real alternative to the Dominion carrying a large share of the relief burden in recent years.

Contrary to common misinformation on the subject, government expenditures on public welfare did not begin in 1930 and they are by no means entirely accounted for by outlay on unemployment and drought relief. For more than

thirty years, these expenditures have been accelerating year by year. The total expenditures of all governments, (Dominion, provincial and municipal) on public welfare, apart from relief, was $15 millions in 1913. By 1921, the figure had risen to $35 millions, by 1930, to $72 millions and, by 1937, it was $124 millions—almost as much as the total relief bill in that year. In fact, these expenditures have kept pace with the growth of economic specialization and urban industrialism. Even if the relief burden were to disappear entirely, there would remain large expenditures on public welfare which were non-existent and undreamed of at the time of Confederation. Thus the difficulties facing the country are not temporary or superficial. Their severity would be moderated by reducing the relief load. It is reasonable to expect the relief expenditures to decline but it must also be expected that they will rise sharply again from time to time. The nature of the economy compels us to expect periodic crises of a similar kind.

Distribution of Powers

The fourth of the considerations which brought the Commission to its final view is the allocation of these new responsibilities between the provinces and the Dominion by the British North America Act. Close examination of the Confederation settlement will show that the Fathers thought they were conferring the costly and fluctuating expenditures of government on the Dominion. The Dominion was given unlimited powers of taxation while the provinces were limited to the imposition of direct taxation within the province. At the time, direct taxes were very unpopular and it was widely held that the use of them by other than municipal governments was impracticable. The provinces were expected to get most of their revenues from licenses and fees and from the public domain. So small were the revenue sources left with the provinces that some of them could not finance the modest obligations which the British North America Act had left with them. Federal subsidies were required to bridge the gap. These subsidies, which were intended to embody a final settlement, were calculated so as to be barely sufficient to balance the budget in the province where the gap was widest. There is no evidence that the Fathers were reluctant to leave the provinces in this cramped position. This indicates that they thought of

provincial obligations as stable and limited while the Dominion was equipped with the full panoply of taxing powers to enable it to meet the unpredictable future.

The Act did not specifically allot the responsibility to provide public welfare services for the simple reason that no one expected government to provide such services. The Privy Council which gives the last word on what the constitution means has held that, as between the provinces and the Dominion, the responsibility for public welfare rests with the provinces. One of the heaviest and most widely fluctuating expenditures of present day government has thus been fixed on the provinces. By a somewhat different process, education and highways, which were long regarded as municipal responsibilities of modest weight, have become costly functions to be borne in large part by the provincial governments. Most of the great expanding peacetime responsibilities of government have come to rest on the provinces whose revenue sources were never intended to carry such a load. This is why the financial settlement made at Confederation has broken down and also why it cannot be made to work again without major revision.

Of course, the provinces have found many new sources of revenue not available in 1867 and have tried to finance the expenditures they were called on to undertake. This stern search for revenues has led the provinces to establish taxation systems which, from the point of view of the country as a whole, are uneconomic, inefficient and inequitable. These tax structures are distorting the economy and adding unnecessarily to burdens which are already grevious enough. The maladjustment in public finance has serious repercussions everywhere.

Moreover, the nature of the economy and the strains to which it is exposed have resulted in wide variations in the fortunes of the different provinces. Some are much less able than others to carry the burdens imposed upon them. The disparities between provinces are due in part to their geographical position and to the nature and extent of their resources. They are also affected in part by the economic policies of the Dominion in such matters as tariffs and railways, although it is quite impossible to measure their exact effect. This fact complicates greatly the relations between the provinces and the Dominion. If the provinces are to

retain a substantial number of their present powers and responsibilities, there seems to be no escape from the necessity for federal grants of assistance to some of them. But there is no agreement at all on the basis on which such grants should be calculated. Some provinces claim to have a right to be compensated for the adverse effect of federal policies. Other provinces deny the existence of such a right. The purpose of such grants must be to bridge gaps between urgent government obligations and available revenues. Because the gaps are of unequal width, it is unfortunately necessary to have grants of unequal amounts. And, as was pointed out at the beginning, the difficulty of finding an agreed formula for treating the provinces unequally has been the cause of much of the political friction in the federal system in recent years.

The researches and deliberations of the Commission convinced them that a comprehensive revision of Dominion-provincial relations is necessary to lighten the burden of public finance on the economy, to improve efficiency at all three levels of government and to restore political harmony in the federation. The plan put forward by the Commission for this purpose will be discussed in a succeeding article.

ECONOMIC NOTES

Canada's Resources Must be Allocated to War Purposes

Editor's Note: This is another in a series of notes on economic subjects by Professor McQueen of the University of Manitoba.

STATEMENTS made in different parts of the country by people of very different views reveal a great misunderstanding of the rigorous requirements for a successful war economy. On the one hand there are groups who seriously propound in high places that the war can be fought without savings and without taxation if only we were to adopt their particular brand of monetary reform and courageously implement it even in the midst of the struggle. There are others who allege that it is not yet time for people to deny themselves the essentials to which they are accustomed and it is seriously argued that any limitation on the use, say, of motor cars will slow down the armament program, presumably because there will be less activity and hence less

income for taxation and war loans. In short both these arguments, propounded as they are by groups far removed from each other in the rest of their thinking, come down to a blunt denial of a proposition which is obvious to General Göering, viz., that in war it is a clear case of "guns or butter." It is notable that the dictators in complete possession as they are of all the economic controls of their countries have no time for the vapourings of monetary reformers or the specious reasoning of particular vested interests. It is worth noting in passing too that the dictators who need pay no attention to the wailings of bankers, labourers or industrialists have found no other way of fighting a war than by shutting off all uses of resources other than those which provide subsistence and war requirements. It is not a vicious monetary system which prevents this from being a world of plenty but it is a shortage of economic resources that prevents it. This the dictators well know and it is time the democracies also realized it if we are to make an intelligent war effort.

That luxuries should be dispensed with in war time is obvious beyond need of proof and they should be dispensed with as quickly as there is use elsewhere in the war effort for the resources which produce them. That many necessities should also be cut down becomes equally obvious when it is considered that there should be restriction of all commodities, be they customary necessities or luxuries, which use materials and labour needed for the war effort. The production of many customary necessities which use up our sources of steel and foreign exchange must be restricted. If steel is needed for tanks the use of it for automobiles should be curtailed and if foreign exchange is needed for aeroplane motors its use for citrus fruits and foreign travel must be cut down. Once all resources are employed—and we are rapidly approaching that point—then it is a case of "guns or butter" for if you want to have the one you cannot have the other.

That these things have become evident is apparent from articles in the financial press and elsewhere. These articles indicate that the "guns or butter" proposition has become so obvious to the authorities that machinery must be at once set up to decide these matters of relative urgency in our war effort. Some machinery for deciding upon the magnitude of our war requirements and the relative priority

of the various war projects is urgently required, for it is now clear that to put a thing on paper is not to produce it. There are just not enough physical resources of labour and machines and materials to go around for every project which has been put on paper. Paper projects like paper money are meaningless once we have reached a stage of reasonably full employment. We say "reasonably full" employment for there is no quick way of absorbing all the untrained unemployed of all ages into occupations requiring technical training and once this admission is made it seems that Canada is within close sight of full employment and we are in a realm not only of "guns or butter" but of "guns or aeroplanes or ships or butter." Half-built guns or ships or aeroplanes are of no use and yet that is what we will get unless there is some intelligent allocation of limited resources to the war effort.

There is reason in the request of these who ask some direction from the authorities with respect to individual expenditures and too little attention has been paid to the wish of the individual citizen to co-operate in any scheme of intelligent war behaviour. To argue that there is no necessity to curtail automobile production in Canada is to argue that there is no scarcity of productive resources—which is manifest nonsense in the light of the facts apparent for some time to the dictators and now becoming painfully apparent in the democracies. To argue that because we have a backed-up surplus of unsold and unsellable wheat we therefore live in a world of plenty would only be true if the wheat could by some act of magic be turned into munitions of war. Nothing could serve the purposes of the dictators better than that we should believe in such fallacies as these and it is to be hoped that the new organization hinted at in the press will see it as one of its important functions to boldly tell the people of Canada that their resources must be rigorously allocated to war purposes to a degree that has not heretofore been necessary.

R. McQUEEN.

20th November 1940.

COST OF PERFORMING A CONTRACT OR SUB-CONTRACT[1]

Comptroller of the Treasury—Cost Accounting Section

Department of Munitions and Supply

General Rule

The cost of performing a particular contract shall consist only of expenditures made by the contractor in connection with the contract, and shall be the sum of:

(1) Direct materials
(2) Direct labour
(3) Direct expenses
(4) A proper proportion of applicable indirect costs (including a reasonable proportion of management expenses).

General Elements of Cost

No definitions of the elements of cost may be stated which are of invariable application to all contractors, but in general the elements of cost may be defined as:

(1) Manufacturing cost[2]
  i Direct materials
  ii Productive labour
  iii Direct engineering labour
  iv Miscellaneous direct factory charges
  v Indirect factory expenses
  vi Other manufacturing cost
(2) Miscellaneous direct expenses
(3) Miscellaneous indirect expenses,

—but there shall not be included as cost any of the following:

(1) Allowances for interest on invested capital, bonds, debentures, bank or other loans,
(2) Entertainment expenses,
(3) Dues and other memberships other than regular trade associations,
(4) Donations (except as stated in Section 3, Subsection b hereunder),
(5) Losses on other contracts,
(6) Losses from sale or exchange of capital assets,
(7) Depreciation on buildings, machinery or equipment paid for by the Crown,
(8) Fines and penalties,
(9) Amortization of unrealized appreciation of values of assets,
(10) Expenses, maintenance and/or depreciation of excess facilities,
(11) Increases in reserves for contingencies, repairs, compensation insurance and guaranteed work,
(12) Federal and provincial income, excess profits or surtaxes,
(13) Unreasonable compensation for officers and employees,
(14) Bond discount or finance charges,

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[1]Published with the kind permission of B. G. McIntyre, Comptroller of the Treasury.

[2]See "Particulars" for further explanation of these six items.

(15) Premiums for life insurance on the lives of officers,
(16) Legal and accounting fees in connection with reorganizations, security issues, or capital stock issues,
(17) Losses on investments, bad debts and expenses of collection,
(18) Advertising and selling expenses.

Particulars

1. Manufacturing Cost

i *Direct Materials*—Includes, in addition to materials purchased solely for the contract and processed by the contractor, or material obtained from subcontractors, any other material purchased for stock which may subsequently be used and becomes a component part of the contract.

All materials shall be charged to the contract at the net laid down price after deducting all discounts and other similar items.

Costs shall be credited with the fair market value of all scrap produced from materials charged to the contract, either in manufacturing processes, rejects, due to design changes, or from any other cause.

ii *Direct Labour*—Production labour which is performed directly on and is properly chargeable to the contract.

iii *Direct Engineering Labour*—Compensation of professional engineers and draftsmen properly chargeable to the contract.

iv *Miscellaneous Direct Factory Charges*—Items properly chargeable direct to the contract, but which do not fall within any of the above categories. As an example, a royalty payable.

v *Indirect Factory Expenses*—"Factory overhead or burden"

(a) Labour: supervision and inspection, clerical, timekeeping, stores, tool crib, cleaners, watchmen, etc.

(b) Materials and supplies: shop fuel, lubricants, waste, non-durable tools and gauges, etc.

(c) Service expenses: expenses of a general nature such as power, heat, light, operation and maintenance of general plant assets and facilities.

(d) Fixed charges: recurring charges such as property taxes, rentals, and provision for depreciation. In making provision for depreciation, consideration may be given the number and lengths of shifts, but the provision shall not be inconsistent with the regulations imparted by Commissioner of Income Tax.

(e) Miscellaneous indirect factory expenses: items not directly chargeable to the contract, such as purchasing expenses, employees' welfare, employer's payments to any Federal unemployment or health fund; but shall not include
(1) Payments deducted or chargeable to employees
(2) Pension and retirement payments.

vi *Other Manufacturing Costs*—Includes items not properly or satisfactorily chargeable to factory costs, but which, upon a complete showing of all pertinent facts, are properly to be included as a cost of the contract, such as:

Experimental and development charges.

2. Miscellaneous Direct Expenses

Sundry items: fees paid for tests, travelling expenses applicable to the contract, etc.

3. Miscellaneous Indirect Expenses

(a) Indirect engineering expense "Engineering Overhead," consisting of labour, materials, and miscellaneous expenses.

(b) Administrative expenses including salaries of corporate and executive officers, office salaries, janitors, cleaners, miscellaneous office and administrative expenses, such as stationery and office supplies, postage, normal contributions to local charities and other necessary office expenses.

Allocation of Indirect Costs

No general rule is applicable to all cases. The proper proportion of indirect costs chargeable to the contract will depend on the ascertaining of all facts and circumstances relating thereto, subject, however, to a requirement that all items which have no relation to the contract shall be eliminated from the amount to be allocated.

Provided the articles produced for the contract are of the same general class as the concurrent production of the plant, then allowable indirect expenses may be distributed on the basis of the proportion which the direct productive labour on the contract bears to the total productive labour of the particular section wherein the contract work may be carried out, except that if indirect expenses are incurred in different amounts and in different proportions by the various producing departments, consideration shall be given to such circumstances to the extent necessary to make a fair and reasonable determination. Administrative and other general expenses may be dealt with in a like manner.

In cases where the product is essentially different to the concurrent production, indirect costs wherever possible shall be segregated and the proper items thereof charged direct to the contract.

Accounts

Contractors' accounts shall be kept in such a manner as to clearly disclose the nature and amounts of the different items of cost pertaining to the contract, and all records of original entry must be preserved in a form available for ready reference until released for disposal by the Minister.

Ottawa
30th September 1940

F. E. WOOD
Head of Cost Section

THE WARTIME PRICES AND TRADE BOARD

Editor's Note—At the last session of Parliament, section 88 of the *Special War Revenue Act* was amended to provide for the levy of a war exchange tax of ten per cent on the value for duty of all goods imported into Canada. After Royal Assent had been given to this amendment on 7th August, H. B. McKinnon, Chairman of The Wartime Prices and Trade Board, sent to manufacturers, importers and distributors in Canada a notice in the form given below:

Immediately below Mr. McKinnon's notice, we publish a recent regulation of the Board which has been kindly furnished to us by Mr. G. W. Jones, the Chief Auditor of the Board.

Notice of Board

To Manufacturers, Importers and Distributors in Canada:

In connection with the War Exchange Tax of 10 per cent on the value for duty of imported goods, your attention is drawn to the following enactment by Parliament:

Special War Revenue Act, Section 88a. (3)

No person shall take advantage of the tax imposed by this section to increase the price of goods by an amount greater than is justified by any increase in cost properly arising from such tax or to maintain prices at levels higher than are so justified and, where the Wartime Prices and Trade Board reports to the Governor in Council that, in its opinion, any person has so taken advantage, the Governor in Council may, upon the recommendation of the said Board, for such period of time as he may determine, impose upon all or any of the goods produced, sold or dealt in by such person an excise tax at a rate not to exceed ten per cent of the selling price of such goods, remove or reduce customs duties applicable thereto, fix the prices thereof and take or authorize the said Board to take such other measures under the Wartime Prices and Trade Board Regulations as the said Board may recommend; and, for the purpose of investigation and any recommendation by the said Board and for the purpose of preventing any such advantage from being taken by any person, the said Board shall have in respect of any such person and goods the powers conferred on it from time to time by such Regulations as if such goods were necessaries of life as therein defined, and the taking of any such advantage shall be deemed to be an offence against this Act and such Regulations, and the penalties prescribed in such Regulations shall extend and apply to such offence.

The Wartime Prices and Trade Board, in undertaking the duties laid upon it by this legislation, assumes that it will have from manufacturing, importing and distributing interests in Canada the fullest co-operation.

In order, therefore, that information which may at any time be requested by the Board may be speedily forthcoming, and in their own interest, all persons, firms or corporations in Canada engaged in manufacturing, importing or distributing goods or commodities of any kind should, following receipt of this notice, be prepared to present upon request:

(*a*) Complete information as to *any* increases in net selling prices effective on or after June 25, 1940, whether such net increases result from a change in the list price or a revision of the terms of payment;

(*b*) Information in detail as to the reasons for such increases in price, e.g., whether attributable to increases in costs arising from the War Exchange Tax, or to the incidence of the Tax itself, or to other causes, such as wage increases, higher cost of materials and components, etc. To facilitate the compilation of data concerning the extent to which selling prices are, or may be, affected by the War Exchange Tax, a record should be maintained of the total amount of this tax paid each month.

(*c*) Any and all information that may be required by the Board, for use by it (i) in investigating such complaints as may be received or (ii) in carrying out generally its duties in pursuance of the legislation above quoted.

Persons subject to the provisions of the Special War Revenue Act in respect of the War Exchange Tax are invited to communicate with the Wartime Prices and Trade Board if seeking information regarding its enforcement.

H. B. McKINNON, Chairman

War Exchange Tax Regulation

It has been declared by the Board as a general rule to be followed that the War Exchange Tax must not be included in the cost upon which the gross profit or "mark up" is added.

This applies especially to imported goods sold in the same condition as received. In such cases it should not be difficult for the importer to know the amount of the tax paid upon importation so that when arriving at the selling price any increase in the price can only be in proportion to the exact amount of the tax paid. Otherwise, the inclusion of the tax in the cost and adding the gross profit or "mark up" to that amount would result in a profit being made on the tax.

On goods made in a Canadian factory in which are incorporated raw materials and partly manufactured parts—some of which may have been obtained from suppliers in Canada who also may have imported them—it would appear a practical impossibility to ascertain the amount of the tax. In such a case, an exception may be made from the general rule, referred to above, regarding the inclusion of the tax in arriving at the selling price. But it must be recognized as an exception and the general rule must be followed wherever possible.

CANADA'S RUBBER INDUSTRY

UNLIKE the pulp and paper industry discussed in last month's issue, the rubber industry is one which contributes directly to the war effort. This modern army does not move on its marching feet rather it moves on its rubber tires—its rubber soles—and depends on its gas masks, capes and protectors. The whole success of the war will depend directly on the mobile vehicles and armoured equipment which industry can prepare, and since rubber is somewhere in every unit it therefore is an essential and its manufacture into the necessities required by the armed forces places a heavy duty on the industry. It is a duty which is not being shirked because the manufacturers in Canada are increasing their production to provide most of the usual complement of articles as well as the special articles required for war purposes. The industry has also responded by increasing its research work and turning the talents of its chemists in an endeavour to find an even stronger and better compound for tires and for the other requirements of the armoured vehicle and the army personnel.

The story of rubber is a fascinating one. From the farthest Eastern plantations to the centres of industrialized sections comes the crude rubber, and from the crude material comes a myriad of varying products ranging from the child's playball to the requirements of the engineer designing and fabricating the most complicated aeroplane.

It took long for the world to understand and utilize the immense potentialities of this crude material but when these potentialities were realized there grew up a whole new industry, that of the automobile, to take advantage of these discoveries. In Canada the industry did not really begin its large operation until the advent of the motor car and until the Great War. In 1913 Canada imported five million pounds of crude rubber; by 1919 imports rose to nineteen million pounds and have steadily increased through the years until the estimated figure for 1940 will be 83 million pounds.

Canada holds a top place in the world industry. Prior to the war she was the sixth largest importer. The industry therefore ranks highly in the industrial structure of this country. Ninety per cent of the imported material comes from the British Empire and from British-owned and con-

trolled plantations. From the Far East it sets out on its long journey lasting from three to four months, and on its arrival in Canada is shipped to the manufacturers settled for the most part in the industrial sections of Ontario and Quebec, there to be moulded and fabricated into fifty thousand different articles. The capital invested in reserves of crude rubber is very large but it is necessary that a good supply be kept on hand in view of the very unsettled conditions in the world today.

The importance of rubber is often overlooked in the manufacture of machines and vehicles. Very often it is the hidden essential without which smooth performance and added safety would be lacking. Its resistance to abrasive wear and its resiliency constitute its importance for tires; as a non-conductor of electricity and as a flexible resilient material, its uses become manifold.

Canada's participation in the war has placed a tremendous burden on the industry. The manufacturing plants were geared to supply Canada's needs and were working with only a small spare capacity. The importance of armed vehicles created a heavy demand for special army tires. These tires are oversize and require certain special properties for their greater utility. To this very necessary part of war-industry, the manufacturers have responded, while keeping up with normal requirements. The need of ground sheets, of gas masks, of special requirements for the machines of war makes it doubtful as to whether the industry can continue to supply all civilian wants while carrying out its duty.

The Canadian industry has had but a brief career but it is one which has been very necessary to a growing industrial life. There are great requirements now and the industry will not fail. The ever-increasing avenues for the use of rubber gives rise to a hopeful outlook for the future and this stable, useful and essential industry may well be proud of its place in Canadian life, of its place in a united Empire and of its place in Canada's and the Empire's war effort.

Rubber as a "Strategic" Material

It is interesting to note in a recent Royal Bank of Canada's news letter a review of the United States of America's problems, as they had been outlined in the *Harvard*

Business Review, in connection with the supply source of many materials necessary in war preparedness. The difference between what is an essential material and what is a "strategic" material is outlined and it is indicated that a strategic material is one which is essential to the war activities of the country but which is dependent in the supply aspect on a foreign country's production. Speaking only of the United States, fourteen such strategic materials are mentioned. Of these fourteen, Canada produces nickel in large quantities and antimony and mercury in sufficient quantities to be a source for some of the United States requirements.

The growing tension in the Far Eastern situation shows increasingly important in view of the other requirements on the list of strategic materials. South Eastern Asia's production of antimony and chromium, Russia's production of manganese ores and British India's production of mica become of the greatest importance. But, outweighing all these, is the production there of rubber and tin. In the event of any serious disturbance in the Far East, the United States alone would have to find 600,000 tons of crude rubber annually. The sources of alternative supply are few. The present sources in the Western Hemisphere (Brazil) are not capable of producing more than about 50,000 tons a year and it would take several years to complete new plantations. The manufacture of reclaimed rubber could be carried on (although some fresh crude rubber is necessary in the process) with the present equipment and yield about 125,000 tons annually. Plant construction to make synthetic rubber would take two or three years and cost approximately two hundred million dollars. The United States government is trying to provide some surplus but under present arrangements enough for eight months' normal requirements only can be managed.

Similarly the problem of tin supply has vexed the United States authorities. A search is being made for a substitute for food containers and it is possible that some of the normal requirements would be available from Bolivian mines. A reserve supply of tin is being provided.

Canada has the same problems augmented by several more of the "strategic" materials the source of supply of which is the United States, but as the United States is

solving its difficulties so we are solving ours and, as the metallurgical industry grows and expands, more and more of our native resources will be utilized and placed on a commercial basis.

This must be a "total war"—the using of every resource and every capacity to the fullest extent in furthering the cause of victory and only when every resource, every plant, every industry and every undertaking is being used with the one purpose in view and only when every effort is made by every individual in each individual's personal capacity, then and only then can victory be within the immediate reach of us all. Germany has prepared to be more self-sufficient; we have not and this problem of supply of "strategic" materials is one which must be solved so that never can our war effort lag because we lack some essential and "strategic" material.

TABLE OF EXCHANGE RATES

(Kindly supplied by The Canadian Bank of Commerce, Toronto)

	31st October 1940	*15th November 1940*
U.S. Dollars	10-11% P.	10-11% P.
Sterling	443-447	443-447
Australian Pounds	358½	358½
New Zealand Pounds	360	360
South African Pounds	446	446
Belgium—Belgas	No quote	No quote
Denmark—Kroner	No quote	No quote
Holland—Florins	No quote	No quote
Finland—Finmarks	194	182
France—Francs	No quote	No quote
Italy—Lire	No quote	No quote
Sweden—Kronor	2638	2638
Switzerland—Francs	2565	2565
Norway—Kroner	No quote	No quote

Note: The above quotations are expressed as follows: Pound currencies—Canadian cents per unit; Continental currencies—Canadian cents per 100 units.

GENERAL NOTES

Our Contributors This Month

H. D. CLAPPERTON who writes in this month's issue on the valuation of unlisted stocks for succession duty purposes is a member of the Society of Chartered Accountants of the Province of Quebec. He became a member in 1919 and was President of the Society in the years 1932-33. For ten years, 1920-1930, he lectured at McGill University in accounting. Mr. Clapperton is now a partner in the firm of Riddell, Stead, Graham and Hutchison, at Montreal.

MAXWELL WEIR MACKENZIE, who deals this month with the recent changes in the operation of foreign exchange control in Canada, has been with the Foreign Exchange Control Board since its inauguration in the Fall of 1939. Mr. Mackenzie is a member of The Society of Chartered Accountants of the Province of Quebec.

Chartered Accountants and the War

Since the publication in the October 1940 issue of the photograph of a number of members of the Provincial Institutes in the R.C.A.F. Accountant Officers' Course at St. Thomas, Ontario, the following additional information has been received:

The Manitoba Institute reports that W. M. Carlyle and Stanley Laing are Captain and Lieutenant respectively in the 15th Light Anti-Air Craft Battery; W. R. Dunwell is Captain in the 37th Field Battery; George M. Black is with the Statistical and Record Branch, National Defence for Air; Lieut. John D. Morison is Paymaster, Artillery Training Centre, Winnipeg; Lieut. Robert Patterson is Paymaster, M.D. No. 12, Regina; and Flight Lieut. W. K. Coutts is with the Accounting Office of the R.C.A.F.

The Nova Scotia Institute sends word that Lieut. J. Esmond Grier, Capt. R. E. MacEwen, and Capt. Wm. Wood are on active service with their respective units.

The British Columbia Institute reports that K. G. Nairn is Wing Commander and is Director of Pay and Accounting Services of the R.C.A.F. and of the Overseas and Joint Em-

pire Training Scheme. Lieut. C. A. Nixon is attached to the Calgary Highlanders of the Second Canadian Division.

Norman Hindsley, Calgary, a member of the Alberta Institute, has been appointed assistant to the Controller, Allied War Supplies Corporation Limited, Montreal.

The Importance of Little Things

In an editorial in the November issue of *The Spokesman,* the monthly bulletin of the Pennsylvania Institute of Certified Public Accountants, Robert J. Bennett dwells on the significance of little things. Both lawyers and accountants, he states, have learned from past experience, sometimes bitter, the tremendous importance of small matters. As lessons can be learned from the ceaseless endeavour of medical research to isolate infinitesimal disease germs and from the fact that the slightest flaw in or near the ship's compass might bring disaster, so too the accountant must be wide awake if he would keep up with the exacting demands, big and little, of income tax laws and the requirements of numerous government departments. All of this, he points out, is most pertinent now when special emphasis is being placed on the demand for more skilled workers on national defence production.

Mr. Bennett is a member of the Institute of Chartered Accountants of Ontario (1902), and, therefore, of our Dominion Association.

Registration of Accountants in Australia

The registration of the members of our profession in Canada by the Dominion Association over a year ago proved to be of considerable assistance when the Government was in need of men with special qualifications.

The use of the accountants' registration scheme in Australia has gone somewhat further than in Canada, and the October issue of *The Australian Accountant* outlines what is being done in the city of Sydney in New South Wales and in the State of Victoria.

The scheme there is to assist the departments of the Navy, Army and Air Force by means of voluntary services of members of the several accountancy Institutes. The

work in the main is internal auditing but in certain branches duties in connection with costing of contracts and stock-taking are being undertaken.

The scheme of work is planned on a roster system which involves two or three evenings' work once every three weeks or so, and in unusual cases a week-end of work. In some cases a group has been attached to a branch or department and carries on under the supervision of its own leaders.

In this way the departments are able to call in assistance when there is a heavy "peak" of back work and have been greatly aided in the carrying out of their duties.

Dominion Natural Gas Company Case

According to a press report the appeal taken by the Minister of National Revenue to the Supreme Court of Canada from the judgment of the Exchequer Court of Canada in the case of *The Dominion Natural Gas Company Limited* v. *The Minister of National Revenue* has been allowed. On the 1934 income tax return of this company, the Minister of National Revenue ruled that the deduction from income, as an expense, of the sum of $48,560.94 for certain legal fees was not an allowable deduction. The company appealed to The Exchequer Court of Canada and the appeal was allowed. The full text of the reasons for judgment of Mr. Justice Maclean was published in the February 1940 issue of THE CANADIAN CHARTERED ACCOUNTANT and a summary of the case (L51) is contained in the volume of Legal Decisions prepared by The Dominion Association of Chartered Accountants.

Judgment in the appeal to the Supreme Court of Canada was handed down on 18th November last, and the decision of that Court was that the appeal should be allowed. At the time this month's issue was going to press, the reasons for judgment had not been received by the Secretary of the Dominion Association, but it is anticipated that further particulars will be published in next month's issue.

Quebec Income Tax

According to the *Quebec Income Tax Act* assented to 22nd June 1940 (for summary thereof see pages PT10 and PT11 (Quebec) of "Summary of Provincial Taxation Respecting

Corporations and Individuals" prepared by The Dominion Association of Chartered Accountants) the rate of tax on personal income is 15% of the amount of tax payable under the Dominion *Income War Tax Act* (and its amendments in force on 1st April 1940). Announcement has just been made by the Government of the Province of Quebec that this rate of 15% has been reduced to 8%. No amendment has yet been made to the Act to provide for the reduction.

Auditor's Liability to Clients—An English Case

A somewhat unusual case on appeal is reported in an early October issue of *The Accountant*. The facts of the case are as follows: the plaintiffs were two sisters who were carrying on, as directors and shareholders, two businesses—one a retail dress shop, the other a dress manufacturing concern. Their claim was for damages which they alleged had been sustained owing to the negligent advice given to them by the defendants, a firm of chartered accountants, whose representative they claimed was their accountant and adviser. In 1934 the retail shop had closed and at that time it owed approximately £1,000 to the manufacturing business. The plaintiffs alleged that on the advice of the accountant this account was written off as a bad debt on the books of the manufacturing company. When later the manufacturing concern went into liquidation the plaintiffs had been compelled to pay this account. Further they claimed to have lost certain directors' fees as a result of negligent advice.

In the lower Court it had been held that the claim failed for the defendant's representative could do no more than advise that the claim should be paid and his advice was not taken, the plaintiffs evidently feeling that, as they for all purposes owned the two businesses, the payment of the account would be a mere formality. The claim in regard to the directors' fees was also dismissed.

In dismissing the appeal their Lordships said that there was no foundation for the claim for negligence or breach of duty if, indeed, there was any duty to advise them at all. The representative of the firm of chartered accountants had performed his duty and being told by the sisters that they would not pay the debt, had written it off.

Excess Profits Tax Bulletin

A copy of the bulletin entitled "Excess Profits Tax Explanatory Brochure" issued by the Department of National Revenue was received just after our November issue had gone to press. Probably most of our readers have obtained a copy of the brochure by now, but if not, they may get one on application to the local inspector of the Income Tax Division of that Department.

According to an Examinee!

The first duty to perform, as Executor of the Will, would be to bury the dead according to his stature in life.

On the granting of probate the court will issue a copy of the Will on parchment with the seal of the court attached to the executor.

Misrepresentation is influencing a person to believe that a certain thing is not that which it is, or that it is such that it is not. Also that a thing shall be when it shall not be, or that it shall not be when it shall be.

See that the cheques are crossed and between the crossed lines write the words "not presentable."

Handwriting—A Dying Art

(from *The Accountants' Journal* of New Zealand)

A paragraph appeared in a weekly paper recently with reference to good handwriting becoming a lost art, and mention was made of the fact that the journal had received from a bank clerk a letter which they had no difficulty in reading, but when it came to the matter of deciphering the signature they were absolutely stumped. Recourse had had to be made to the local branch of the bank to help them out of their difficulty. Evidently this was a case where the writer had omitted to type his name beneath his signature, so as to give the person to whom the letter was addressed the opportunity of replying. If those who wrote fantastic and inelegant signatures only knew that these are more easily forged than good plain signatures, they would perhaps modify their methods.

Despite the opinions expressed in some quarters that present day handwriting as a whole compares unfavourably with the handwriting of a couple of generations ago, it should not be overlooked that bad writers, like bad cooks, have inflicted themselves upon a suffering world all through the ages.

It is on record that many years ago in one of our cities before the advent of the stenographer and the typewriter, there lived a solicitor whose calligraphy was so uncertain that no one but his managing clerk was able to read what he had written. Even he

himself was denied the pleasure of reading his own notes. In the course of time it came to pass, unfortunately, that the managing clerk died, with the sad result that the learned man of the law was compelled to give up business, because there was no one to be found who could read his writing. In circumstances similar to this there was in America a typesetter in a newspaper office who prided himself that he was the only one who could read the extremely bad writing of the editor, whose mind was so much taken up with the matter of his leaders that he wholly neglected the manner of committing them to paper, much to the despair of the remaining members of the printing department. In order to prove the typesetter's ability to set the editor's famous "copy," it was decided one day, by way of a joke, to secure two fighting cocks and, after dipping their feet in ink, set them down in front of each other with a large sheet of plain newsprint as a carpet. When these two birds had liberally covered the paper with curious inkmarks, after some brisk minutes of "mat work," the paper was cut into suitable shape and size to match that on which the editor usually wrote his articles, and handed to the expert printer. It is said that after some little hesitation at first, he soon warmed up to his work, and quickly set up into type one of the most striking articles ever attributed to the editor's pen.

This brings us back to the point as to whether bank officers should write their names clearly or indistinctly. If they follow the second method, and there was a substantial lottery prize depending upon the correct interpretation of their names it would be just too bad, whereas if they signed an I.O.U., for instance, with a plain signature, that would be just too bad, also. The question therefore arises whether the decay of good penmanship amongst the moderns is a blessing or otherwise.

PROVINCIAL NEWS

MANITOBA

The rapid strides which have been made in the development and adaptation of business machines during recent years, and their effect on accounting and auditing procedure, are of vital concern to the professional accountant. In order therefore to give members and students of The Institute of Chartered Accountants of Manitoba an opportunity of becoming more familiar with some of the accounting and calculating machines, the Committee on Students' Studies arranged for a series of demonstrations. The students taking the Bachelor of Commerce course of The University of Manitoba were also invited.

Four meetings have been held to date and the respective Winnipeg representatives of the National, Monroe, Elliott Fisher and Hollerith machines conducted demonstrations which were both interesting and instructive. With the exception of the Hollerith machines, which were demonstrated in the offices of The Great-West Life Assurance

Company, the meetings took place at The University, and ample opportunity was afforded for questions and discussion.

QUEBEC

At a meeting of the members in Quebec City of the Society of Chartered Accountants of the Province of Quebec, held at the Garrison Club, Quebec City, 19th October 1940, the following board was elected for the year 1940-41: President, J. A. Towner; vice-president, G. H. Boulet; secretary-treasurer, Rosaire Courtois; directors: C. Belanger, M. Boulanger, P. H. Huot, F. Lafferty, and John O'Neill; and Guy Fortier, auditor.

It may be stated for the benefit of readers that the main object of this local committee is to group all the chartered accountants residing in the city of Quebec and the immediate district for the general purpose of arranging meetings at which lectures on accounting and other subjects will be given; to hold social gatherings so that members will have an opportunity of meeting each other; to hold test examinations and lectures for students preparing for the examinations of the Society; and to engage in all other activities in the interest and well-being of the members. Another important purpose of the committee is making such recommendations for the consideration of the Council of the Society as it may deem desirable.

PERSONAL

Messrs. Harvey A. Lever and J. Frank Hoskin announce that they have formed a partnership for the practice of their profession as Chartered Accountants under the name of Lever and Hoskin with offices at 1305 Metropolitan Building, Toronto.

STUDENTS' DEPARTMENT

R. G. H. SMAILS, C.A., Editor

NOTES AND COMMENT

The customary attitude towards the organization or preliminary expenses of a limited liability company is one of suspicion and it is said that these outlays should be absorbed by surplus over a relatively short period, say three to five years. If the title "organization expenses" is restricted, as it should be, to the actual expenditures incurred in promoting the company and securing its incorporation it can be argued with some force that this conventional treatment, while conservative, is quite lacking in any logical basis. These expenditures—the argument runs—are presumably made because they are worth making, that is to say because they result in what is considered a commensurate gain, the opportunity to engage in business with the privilege of limited liability. So long as the company continues as a going concern, successful in the prosecution of its enterprise, this asset remains undiminished and its amortization amounts to a forced investment exacted needlessly from the shareholders. It is admittedly otherwise if the company, though formed with a view to perpetual existence, should prove unable to operate successfully, or if the company were formed to exploit a wasting asset. In the first of these two situations the item measures capital sunk and lost, in the second it is itself a wasting asset to be written off over the estimated life of the enterprise by charges against earnings rather than by appropriations of earned profit.

Whatever treatment is accorded to organization expenses it is essential that the item should be restricted to costs associated with incorporation, (such as legal fees, incorporation fees, cost of statutory books and common seal), and that so much of it as remains on the books from time to time should be presented on the balance sheet by itself and for what it is. Particularly it would seem to be desirable to exclude from organization expenses commissions and other expenses in connection with the issue of either perpetual or terminable securities.

There was brought to our notice some time ago an ingenious device copyrighted by The Consumers' Gas Company of Toronto whereby tables of finance charges on instalment sales were computed in booklet form and then printed-off on cards so that every customer could be given a durable copy of the table appropriate to his own contract. Each table contained columns for "Number of Payments," "Total Balance Due," "Cash Discount Available," and "Principal Balance Unpaid," so that the customer could see at a glance the balance which he owed at any time, the figure for which he could settle for cash at any time, and the actual amount he was paying month by month for the credit facilities. Each table covered up to 48 monthly instalments and the monthly payments to which the successive tables related ran from twenty-five cents up to $12.50. This scheme would seem to be a great improvement on the method not uncommon in instalment selling, which leaves the buyer in the dark as to the precise status of his account at points intervening between the down payment and the final payment.

* * *

The accountant's worries over the control of returnable containers and the calculation of loss or gain on containers are steadily diminishing as, for an ever-increasing list of products which have to be marketed in containers, human ingenuity is devising containers of such low cost in proportion to the value of the product that the cost of the container can be recouped in the price of the product without affecting the volume of sales. The classic example of a process, beneficial to both producer and consumer, is the substitution of the paper bag for the jute sack in the cement industry. Outstanding examples of obdurate goods are milk and soft drinks, but it is probable that even these will yield in time to inventive genius.

* * *

Through the kindness of Mr. D. R. Patton, C.A., lecturer to The Chartered Accountants Students' Society of the Province of Quebec, the Students' Department has received a copy of Lecture No. 9 in the series of Fall Lectures—1940, Final Cost Accounting. This consists of four problems in cost accounting together with suggested solutions to the problems. With Mr. Patton's permission one of these prob-

lems is reproduced in the "Problems and Solutions" section of this issue.

* * *

STUDENT ASSOCIATION NOTES

ALBERTA

The Secretary of the Alberta Institute reports that Dennis Quinlan and Stanley Garside have enlisted in the Royal Canadian Air Force.

* * *

PROBLEMS AND SOLUTIONS

Solutions presented in this section are prepared by practising members of the several provincial Institutes and represent the personal views and opinions of those members. They are designed not as models for submission to the examiner but rather as such discussion and explanation of the problem as will make its study of benefit to the student. Discussion of solutions presented is cordially invited.

PROBLEM I

THE PROVINCIAL INSTITUTES OF CHARTERED ACCOUNTANTS

FINAL EXAMINATION, 1939

AUDITING I

Question 1

(a) What do you understand by the phrase "lower of cost or market" as descriptive of merchandise inventory valuations?

(b) In each of the following instances would you, as auditor, be prepared to certify, without qualification, a balance sheet in which inventory valuations are described as "the lower of cost or market"? Support your views with explanations:

(1) A department store deducts from the inventory taken at selling price, a mark-up percentage resulting from the excess of the original selling price at the time the merchandise was first offered for sale, over the laid-down cost. The selling price for inventory purposes has been subjected to mark-down reductions.

(2) A retailer dealing in style merchandise, has a quantity of prior season's stock, which is therefore not subject to replacement costs. A reduced selling price still exceeds cost, but would result in the disposal of the merchandise at a gross profit, probably insufficient to cover sales clerks' salaries, occupancy, advertising and other selling expenses. The inventory is valued at cost.

(3) A manufacturer values his inventory at standard cost. The actual cost of direct labour and direct materials exceeds standards, but standards for plant overhead based on a normal run exceed the actual plant overhead incurred for the merchandise in the inventory. Both actual and standard costs are below selling prices minus selling expenses.

(4) An automobile dealer accepts used automobiles as a portion of the purchase price of new units sold. The cost of the "trade-ins" as ascertained for inventory purposes includes the trade-in allowance, cost of reconditioning and financing charges to the date of the inventory. In the past the dealer has ordinarily failed to realize the cost of used units. The selling price of the units is subject to salesmen's commissions and to a service guarantee.

(5) A wholesale concern operating a number of branches occasionally ships merchandise between branches as a matter of expediency. The inter-branch transportation charges so incurred are added by the receiving branch to the invoiced laid-down cost of the shipping branch. The cost invoiced to the receiving branch is less than selling price (minus selling expenses) and is utilized for inventory purposes.

SOLUTION

(a) A consideration of the phrase "lower of cost or market" necessitates a definition of the terms "cost" and "market." I would define the term cost applicable to a merchandising establishment as being laid down cost, that is the net invoice price plus a proper proportion of freight and duty to the door of the establishment. Cost as defined should be for quantities ordinarily purchased and under conditions ordinarily obtaining. Whether the invoice cost should be reduced by cash discounts would depend on the size of the discount and on the trade practice of the company. The cost to a manufacturing establishment would include the cost of materials, the direct labour and a proper proportion of manufacturing expenses. Manufacturing expenses should exclude interest on capital.

I would define market as meaning replacement cost for quantities ordinarily purchased, and under conditions ordinarily obtaining; if, however, existing selling price less the direct cost of selling (such as agents' commissions and other apportionable selling expenses) is less than replacement cost, then I would recognize selling price as market. The term market presupposes realizability.

(b) (1) The retail inventory system does not exactly conform with the definition of cost or market which I have stated in the previous paragraph, which I believe to be the usual accounting concept of that phrase. Valuations in a retail inventory system are based on the premise that future trading periods are entitled to the same margin of profit as they would have earned if the merchandise had been purchased during the financial period in which they are sold. With respect to merchandise which has been marked down and which is still in the inventory at the end of the year, there is a possibility that inventory valuations will be below not only actual cost, but also replacement. However, in the first place the procedure is conservative, and in the second place it has become an accepted trade practice. With this in mind, and providing that mark downs are not excessive or have been made with the intention of unduly understating valuations; provided too that the method is followed consistently from year to year, I would be prepared to accept an inventory valued on the retail inventory system, and describe it as the "lower of cost or market" without qualification.

(2) As I have previously stated the term "cost or market" definitely presupposes realizability. In this case the realizable value of the inventory is less than that stated for balance sheet purposes, due to the lack of provision for selling expenses. Selling prices should be reduced by a proper proportion of selling expenses. This procedure should be followed consistently from year to year.

(3) There are strong advocates among accountants for the utilization of standard rather than actual costs. In my opinion there is less justification for this procedure with respect to price variances than there is in respect to time or efficiency variances. With respect to the former, the variances may have been beyond the control of the management; the latter may be due to inefficiency, or other controllable factors which theoretically might be excluded from inventory values. Standard rates for the application of overhead introduces another problem. There would seem to be nothing inconsistent with current costing practice in utilizing a standard application rate based on a normal run. In my opinion, therefore, the usually accepted term "cost" conveys actual cost at rates and prices for the actual time spent, although excessive wastage and spoilage may be eliminated. Standard costs which do not comply with this should not be expressed as "the lower of cost or market." Here again consistency of treatment from year to year is an important aspect.

(4) The inclusion of financing charges in the cost of used automobile trade-ins is not proper for inventory purposes. If, after the elimination of this figure, cost still exceeds realizable value (that is, selling price minus selling commissions and other selling expenses), the inventory should be repriced so that each unit is stated at the lower of cost or realizable value. This procedure should be consistently followed from year to year.

(5) The acceptance of "the lower of cost or replacement cost" as synonymous with "the lower of cost or market," would require that the transferred merchandise be valued at original invoice cost plus such transportation charges as would have been incurred if the merchandise had been shipped originally to the branch at which it is now inventoried. This procedure should be followed consistently from year to year.

PROBLEM II

THE PROVINCIAL INSTITUTES OF CHARTERED ACCOUNTANTS

FINAL EXAMINATION, 1939

AUDITING I

Question 4

By the terms of the audit appointment you are required to report to the directors on significant aspects of the operating results for the year. The unit selling price of the product was reduced 10% at the commencement of 1938, but otherwise has been stable throughout 1937 and 1938. Condensed comparative operating statements for the two years are as follows:

	1937	1938
Sales	$400,000.00	$450,000.00
Cost of Sales	300,000.00	363,000.00
Gross Profit	$100,000.00	$ 87,000.00
Expenses		
Invariable	25,000.00	25,000.00
Variable	40,000.00	36,000.00
	$ 65,000.00	$ 61,000.00
Net Profit	$ 35,000.00	$ 26,000.00

Present the section of the report required.

SOLUTION

Operations

The following statement presents in condensed comparative form a summary of operations expressed in dollars and in percentages of sales for the year 1938 as compared with the previous year 1937:

	1937		1938	
	Amount	% to Sales	Amount	% to Sales
Sales	$400,000	100.00	$450,000	100.0
Cost of sales	300,000	75.00	363,000	80.7
Gross profit	100,000	25.00	87,000	19.3
Expenses				
Invariable	25,000	6.25	25,000	5.5
Variable	40,000	10.00	36,000	8.0
	65,000	16.25	61,000	13.5
Net Profit	35,000	8.75	26,000	5.8

The decline in gross profit for the year is attributable to decline of 10% in selling price of the company's product which went into effect at the beginning of the year under review. The reduction of profits in this respect, however, has been partially offset by an increased volume of sales, a decrease in operating costs and a reduction in those expenses which would ordinarily be expected to increase as sales increased. This may be summarized in the following statement accounting for the variation in net profit:

Factors reducing profits

Decline in selling prices:			
This year's sales at last year's prices $\$450{,}000 \times \frac{100}{90}$		$500,000	
This year's sales at this year's prices		450,000	$ 50,000

Factors increasing profits

Increase in volume:			
This year's sales at last year's prices		$500,000	
Last year's sales		400,000	
Increase in volume		100,000	
Gross profit 25%		25,000	
Less: Expected increase in variable expenses			
Expected expenses 10% of $500,000	$ 50,000		
Prior year's expenses	40,000	10,000	
		15,000	

Decrease in costs

This year's costs on last year's basis —75% of $500,000	375,000		
This year's costs	363,000	12,000	

Reduction in variable expenses

Variable expenses on prior year's basis—10% of $500,000	50,000		
Variable expenses actual	36,000	14,000	41,000
Increase in Profits			$ 9,000

(Similar conclusions can be arrived at by adopting an assumed production in 1937 of say 100,000 units. From there the cost per unit can be ascertained including the variable and invariable expenses per unit, the unit selling price and the net profit. By reducing the unit cost in 1937 by 10% the student will then find that there has been an increase in volume in 1938 of a specific number of units, a decrease in cost, and a decline in selling prices—a procedure which will lead him logically to conclusions similar to the above. Since this method, however, would necessitate an assumption of the number of units produced in 1937 not supplied in the question, the above form of solution would seem preferable.)

PROBLEM III

THE CHARTERED ACCOUNTANTS STUDENTS' SOCIETY OF THE PROVINCE OF QUEBEC

FALL LECTURES—1940: FINAL COST ACCOUNTING

D. R. PATTON, C.A., *Lecturer*

The Interprovincial Manufacturing Co. Ltd. manufactures a single product which is composed of three parts known as Part X, Part Y and Part Z. Parts X and Y are manufactured in the company's plant and Part Z is purchased ready for assembly. Part X is manufactured in Dept. 1, Part Y in Dept. 2 and the three parts are assembled into the finished product in Dept. 3.

The standard cost system used by the Interprovincial Mfg. Co. Ltd. is interlocked with the general accounting system. Standard costs are debited and credited to stores and work-in-process accounts, and the differences are carried directly to variance accounts. One work-in-process account is carried for each department.

The budget and schedule of standard costs for the month of January have been prepared as follows:

INTERPROVINCIAL MANUFACTURING CO. LTD.—BUDGET AND SCHEDULE OF STANDARD COSTS

FOR MONTH OF JANUARY

		Standard Price	Budgeted No. of units and actual sales	Amount
SALES		$20.000	12,000	$240,000
COST OF GOODS—(Based on 12,000 units)				
(1) PART X—				
Direct material	$2.002			
Direct labour	1.000			
Manufacturing expense (total applicable to Dept. 1—$7,200)	.600	3.602	12,000	43,224

(2) PART Y—				
Direct material	3.003			
Direct labour	2.000			
Manufacturing expense (total applicable to Dept. 2—$9,600)	.800	5.803	12,000	69,636
(3) ASSEMBLY COST—				
Part Z	.500			
Direct labour	.600			
Manufacturing expense (total applicable to Dept. 3—$4,800)	.400	1.500	12,000	18,000
		$10.905	12,000	$130,860

GROSS PROFIT	$109,140
Selling and administrative expense	60,000
NET PROFIT	$ 49,140

The Inventories on January 1st were as follows—

Stores	$200,000
Finished parts—X 6,000 at $ 3.602	21,612
Finished parts—Y 6,000 at 5.803	34,818
Finished goods— 4,000 at 10.905	43,620
Total	$300,050

No Inventories of work-in-process are on hand on January 1st nor on January 31st.

The following are the total transactions for the month—

(a) *Purchases*

Actual price	$54,000
Standard price	52,000

(b) *Requisition of direct materials from stores* (at standard price)

Dept. 1	$20,500
Dept. 2	24,300
Dept. 3 (Part Z)	5,000
	$49,800

(c) *Factory pay roll*

Direct labour—Dept. 1	$10,200
—Dept. 2	16,320
—Dept. 3	6,400
Indirect labour	10,000
	$42,920

(d) *Maufacturing expense* — excluding indirect labour $11,800

(e) *Production*

Part X	10,000 units
Part Y	8,000 units
Finished Goods	10,000 units

(f) *Selling and administrative Expense* $58,000

. . . .

1. Prepare Journal Entries giving effect to the foregoing transactions, and providing accounts to show variances from standards in respect to the following:—
   (a) Material—Price
   (b) Material—Quantity
   (c) Direct labour
   (d) Burden—Underabsorbed
   (e) Burden—Expense (comparison between actual and standard burden at present level)
   (f) Selling and administrative expense.
2. Post the entries to ledger accounts.
3. Prepare profit and loss statement—showing variances from standards.

SOLUTION

THE INTERPROVINCIAL MANUFACTURING CO. LTD.—JOURNAL

ENTRIES TO RECORD TRANSACTIONS

(1)

(a) Stores	$ 52,000	
Material variance—Price	2,000	
Accounts payable		$54,000
Month's purchases, costing $54,000 ·		
Standard price $52,000		
(b) Work-in-process—Dept. 1	20,020	
Work-in-process—Dept. 2	24,024	
Work-in-process—Dept. 3	5,000	
Material variance—Quantity—Dept. 1	480	
Material variance—Quantity—Dept. 2	276	
Stores		49,800
Materials requisitioned from stores—		
Standard—		
Dept. 1—10,000 units @ $2.002 $20,020		
Dept. 2— 8,000 units @ 3.003 24,024		
Dept. 3—10,000 units @ .50 5,000		
(c) Work-in-process—Dept. 1	10,000	
Work-in-process—Dept. 2	16,000	
Work-in-process—Dept. 3	6,000	
Direct labour variance cost—Dept. 1	200	
Direct labour variance cost—Dept. 2	320	
Direct labour variance cost—Dept. 3	400	
Manufacturing expense	10,000	
Accrued payroll		42,920
Factory payroll for month — Direct & Indirect		
Standard—		
Dept. 1—10,000 units @ $1.00—$10,000 (direct)—		
Dept. 2— 8,000 units @ $2.00— 16,000		
Dept. 3—10,000 units @ .60— 6,000		

(d) 1. Manufacturing expense	11,800	
Accounts payable		11,800
Manufacturing expense *incurred* for month—Excluding indirect labour.		

2. Work-in-process—Dept. 1	6,000	
Work-in-process—Dept. 2	6,400	
Work-in-process—Dept. 3	4,000	
Applied manufacturing expense		16,400
Standard—		
Dept. 1—10,000 units @ .60—$6,000		
Dept. 2— 8,000 units @ .80— 6,400		
Dept. 3—10,000 units @ .40— 4,000		

3. Applied manufacturing expense	16,400	
Burden Variance—manufacturing expense under-applied—Dept. 1	1,200	
Burden Variance—manufacturing expense under-applied—Dept. 2	3,200	
Burden Variance—manufacturing expense under-applied—Dept. 3	800	
Burden Variance — manufacturing expense cost (Expense)	200	
Manufacturing expense		21,800
Factory burden for month.		

(e) PRODUCTION

Finished parts—X	36,020	
Work-in-process—Dept. 1		36,020
10,000 parts X @ $3.602.		
Finished parts—Y	46,424	
Work-in-process—Dept. 2		46,424
8,000 parts @ $5.803.		
Work-in-process—Dept. 3	94,050	
Finished parts—		
X 10,000 parts @ $3.602		36,020
Y 10,000 parts @ 5.803		58,030
Finished goods	109,050	
Work-in-process—Dept. 3		109,050
10,000 units @ $10.905.		

SALES

Cost of goods sold	130,860	
Finished goods		130,860
Sales—12,000 units @ cost of $10.905.		
Accounts receivable	240,000	
Sales		240,000
Sales—12,000 units @ S.P. of $20.		

(f) Selling & administrative expense	60,000	
Variance—Selling & admin. expense..		2,000
Accounts payable, etc.		58,000
Standard—$60,000—Variance $2,000 Cr.		

THE INTERPROVINCIAL MANUFACTURING CO. LTD.

PROFIT AND LOSS STATEMENT

For Month of January

Sales—12,000 units @ $20.00				$240,000
Cost of goods sold				
Standard cost—12,000 units @ $10.905			$130,860	
Variances				
Material—Price		$2,000		
Material—Quantity—Dept. 1	$ 480			
Material—Quantity—Dept. 2	276			
		756		
Direct labour—Cost—Dept. 1	200			
Direct labour—Cost—Dept. 2	320			
Direct labour—Cost—Dept. 3	400			
		920		
Burden—Underabsorbed—Dept. 1	1,200			
Burden—Underabsorbed—Dept. 2	3,200			
Burden—Underabsorbed—Dept. 3	800			
		5,200		
Burden—Mfg. expense Cost (Expense)		200	9,076	
Cost of goods sold				139,936
Gross profit				100,064
Selling and administrative expense				
Standard			60,000	
Variance			2,000 Cr.	58,000
Net profit for month				$42,064